

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)	
POWER COMPANY FOR THE SIX-MONTH)	CASE NO.
BILLING PERIODS ENDING DECEMBER 31, 2002,)	2006-00128
DECEMBER 31, 2003, JUNE 30, 2004,)	
DECEMBER 31, 2004, AND DECEMBER 31, 2005,)	
AND FOR THE TWO-YEAR BILLING PERIODS)	
ENDING JUNE 30, 2003 AND JUNE 30, 2005)	

O R D E R

On May 27, 1997, the Commission approved Kentucky Power Company's ("Kentucky Power") environmental surcharge application and established a surcharge mechanism.¹ Pursuant to KRS 278.183(3), at 6-month intervals, the Commission must review 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 surcharges with actual costs that are recoverable pursuant to KRS 278.183(1). At 2-year intervals, the Commission must review and evaluate the past operations of the environmental surcharge. After hearing, the Commission must disallow improper expenses and, to the extent appropriate, incorporate surcharge amounts found just and reasonable into the existing base rates of the utility.

¹ 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, final Order dated May 27, 1997.

The Commission has determined that it will be administratively efficient and reasonable to review the pending 6-month periods and the 2-year periods in the same case. Therefore, the Commission hereby initiates the 6-month reviews of the surcharge as billed from July 1, 2002 to December 31, 2002, from July 1, 2003 to December 31, 2003, from January 1, 2004 to June 30, 2004, from July 1, 2004 to December 31, 2004, and from July 1, 2005 to December 31, 2005, and the 2-year reviews of the surcharge as billed from July 1, 2001 to June 30, 2003 and July 1, 2003 to June 30, 2005.²

To facilitate this review, a procedural schedule is set forth in Appendix A, attached hereto and incorporated herein. In accordance with that schedule, Kentucky Power is to file prepared direct testimony: (a) in support of the reasonableness of the application of its environmental surcharge mechanism during the time periods under review; and (b) on a proposal to roll-in its environmental surcharge into existing base rates. In addition, Kentucky Power is to file its response to the information requested in Appendix B, attached hereto and incorporated herein. Since each of the periods under review in this proceeding may have resulted in over- or under-recoveries, the Commission will entertain proposals to adopt one adjustment factor to net all over- or under-recoveries.

² Since Kentucky Power's surcharge is billed on a two-month lag, the amounts billed from July 2002 through December 2002 are based on costs incurred from May 2002 through October 2002; amounts billed from July 2003 through December 2003 are based on costs incurred from May 2003 through October 2003; amounts billed from January 2004 through June 2004 are based on costs incurred from November 2003 through April 2004; amounts billed from July 2004 through December 2004 are based on costs incurred from May 2004 through October 2004; amounts billed from July 2005 through December 2005 are based on costs incurred from May 2005 through October 2005; amounts billed from July 2001 through June 2003 are based on costs incurred through May 2001 through April 2003; and amounts billed from July 2003 through June 2005 are based on costs incurred from May 2003 through April 2005.

Since the approval of its original environmental compliance plan and surcharge mechanism, Kentucky Power has sought and been granted two amendments to its original compliance plan and surcharge mechanism.³ In Case No. 2005-00341,⁴ the capital expenditures and operating expenses associated with the original and first amendment to the environmental compliance plan as of the test-year were rolled-in to Kentucky Power's base rates. After this roll-in, the environmental surcharge provides recovery of the incremental costs associated with the original and first amendment to the compliance plan as well as the costs associated with the second amendment to the compliance plan. When determining its over- and under-recovery of the surcharge in this proceeding, Kentucky Power should reflect the impacts of these prior cases, as applicable.

IT IS THEREFORE ORDERED that:

1. The procedural schedule set forth in Appendix A, attached hereto and incorporated herein, shall be followed in this proceeding.

³ See 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; 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; and 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.

⁴ Case No. 2005-00341, General Adjustments of Electric Rates of Kentucky Power Company, final Order dated March 14, 2006.

2. Kentucky Power shall appear at the Commission's offices on the date set forth in Appendix A, to submit itself to examination on the application of its environmental surcharge as billed to consumers from (a) July 1, 2002 through December 31, 2002; (b) July 1, 2003 through December 31, 2003; (c) January 1, 2004 through June 30, 2004; (d) July 1, 2004 through December 31, 2004; (e) July 1, 2005 through December 31, 2005; (f) July 1, 2001 through June 30, 2003; and, (g) July 1, 2003 through June 30, 2005. At the public hearing there shall be no opening statements or summaries of testimony.

3. Kentucky Power shall give notice of the hearing in accordance with the provisions of 807 KAR 5:011, Section 8(5). At the time publication is requested, Kentucky Power shall forward a duplicate of the notice and request to the Commission.

4. Kentucky Power shall, by the date set forth in Appendix A, file the information requested in Appendix B, attached hereto and incorporated herein, along with its prepared direct testimony in support of the reasonableness of the application of its environmental surcharge mechanism during the seven periods under review.

5. Any party filing testimony shall file an original and 9 copies.

6. All requests for information and responses thereto shall be appropriately indexed, and an original and 6 copies shall be filed with the Commission, with copies to all parties of record. Any request for information from the Commission Staff shall be responded to as if set forth in a Commission order. All responses shall include the name of the witness who will be responsible for responding to questions related to the information provided.

7. Within 7 days of the Commission granting intervention to a party, Kentucky Power shall provide the party with a copy of its monthly environmental surcharge reports as filed with the Commission for each review period.

8. Kentucky Power's monthly environmental surcharge reports and supporting data for the review periods shall be incorporated by reference into the record of this case.

9. The case records of Case Nos. 1996-00489, 2002-00169, 2004-00081, 2005-00068, and 2005-00341 shall be incorporated by reference into the record of this case.

10. Any objections or motions relating to discovery or procedural dates shall be filed upon 4 business days' notice or shall include an explanation why such notice was not possible.

Done at Frankfort, Kentucky, this 25th day of April, 2006.

By the Commission

ATTEST:



Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2006-00128 DATED April 25, 2006

- Kentucky Power shall file its prepared direct testimony and responses to the information requested in Appendix B no later than 05/23/06
- An informal technical conference is to begin at 10:00 a.m., Eastern Daylight Time, in Conference Room 1 of the Commission's offices at 211 Sower Boulevard, Frankfort, Kentucky for the discussion of issues 05/31/06
- All additional requests for information to Kentucky Power shall be filed no later than 06/14/06
- Kentucky Power shall file responses to additional requests for information no later than..... 06/28/06
- Intervenor testimony, if any, in verified prepared form shall be filed no later than 07/07/06
- All requests for information to Intervenors shall be filed no later than..... 07/21/06
- Intervenors shall file responses to requests for information no later than..... 08/04/06
- Last day for Kentucky Power to publish notice of hearing date To be scheduled
- Public Hearing is to begin at 9:00 a.m., Eastern Daylight Time, in Hearing Room 1 of the Commission's offices at 211 Sower Boulevard, Frankfort, Kentucky, for the purpose of cross-examination of witnesses of Kentucky Power and Intervenors To be scheduled
- Briefs, if any, shall be filed by To be scheduled

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2006-00128 DATED April 25, 2006

FIRST DATA REQUEST OF COMMISSION STAFF TO KENTUCKY POWER COMPANY

For Each of the Seven Periods Under Review

1. Prepare a summary schedule showing the calculation of E(m) and the surcharge factor for the expense months covered by the applicable billing period. Use ES Form 1.0 as a model for this summary. Include the expense months for the two expense months subsequent to the billing period in order to show the over- and under-recovery adjustments for the months included for the billing period under review. Include a calculation of any additional over- or under-recovery amount Kentucky Power believes needs to be recognized for each 6-month review or 2-year review. Include all supporting calculations and documentation for any such additional over- or under-recovery.

2. The net gain or loss from sulfur dioxide ("SO₂") and nitrogen oxide ("NO_x") emission allowance sales are reported on ES Form 3.0, Calculation of Current Period Revenue Requirement, Third Component. For each expense month covered by the applicable billing period, provide an explanation of how the gain or loss reported in the expense month was calculated and describe the transaction(s) that was the source of the gain or loss.

3. The SO₂ emission allowance inventory is reported on ES Form 3.11, SO₂ Emission Allowance Inventory (prior to the March 2003 expense month, ES Form 3.12,

Emission Allowance Inventory). The most frequent addition to the SO₂ emission allowance inventory is classified as "Other" on ES Form 3.11. For each of the applicable billing periods under review:

- a. Describe the types of transactions reported in the Other category.
- b. Explain why Kentucky Power acquired these additional allowances.
- c. Explain how the price per allowance for this category of emissions

allowance is determined.

4. Provide the percentage of Kentucky Power's long-term debt that has a variable interest rate as of the last expense month in the applicable billing period under review.

5. Included in the environmental costs reported on ES Form 3.10, Costs Associated with Big Sandy, are property taxes. Explain the reason(s) for the fluctuations in the property taxes during the seven review periods.

Billing Period from July 1, 2001 through June 30, 2003

6. Refer to ES Form 3.10, Cost Associated with Big Sandy, for the December 2002 expense month. Explain the reason(s) for the increases in the Gavin scrubber costs reported for the December 2002 expense month.

7. Refer to ES Form 3.12, Emission Allowance Inventory, for the December 2002 and February 2003 expense months and ES Form 3.11, SO₂ Emission Allowance Inventory, for the April 2003 expense month.

- a. Describe the type of transaction reported as "Withdrawals – Intercompany Sales."

b. Explain how the sales price per allowance was determined for these sales.

Billing Period from July 1, 2003 through December 31, 2003

8. Refer to ES Form 3.11, SO₂ Emission Allowance Inventory, for the May 2003 through August 2003 expense months.

a. Describe the type of transaction reported as “Withdrawals – Intercompany Sales.”

b. Explain how the sales price per allowance was determined for these sales.

Billing Period from January 1, 2004 through June 30, 2004

9. Refer to ES Form 3.11, SO₂ Emission Allowance Inventory, for the December 2003 expense month.

a. Describe the type of transaction reported as “Withdrawals – Intercompany Sales.”

b. Explain how the sales price per allowance was determined for these sales.

10. Refer to ES Form 3.11, SO₂ Emission Allowance Inventory, for the March 2004 expense month. Explain why Kentucky Power’s utilization of SO₂ emission allowances in this expense month was so much lower than other months in this billing period.

Billing Period from July 1, 2004 through December 31, 2004

11. Refer to ES Form 3.14, Gavin Scrubber Costs, for the June 2004 and October 2004 expense months. Explain why lime costs were higher in these months as compared to the other months in the billing period.

Billing Period from July 1, 2003 through June 30, 2005

12. Refer to ES Form 3.11, SO₂ Emission Allowance Inventory, for the January 2005 expense month. Explain why Kentucky Power's utilization of SO₂ emission allowances in this expense month was so much lower than other months in this billing period.

13. In Case No. 1996-00489, the Commission ordered that Kentucky Power's rate of return on common equity for the environmental surcharge would be reviewed for reasonableness during the 2-year review case. In Case No. 2005-00341, the approved Settlement Agreement provided that Kentucky Power would utilize a 10.5 percent rate of return on common equity.

a. Does Kentucky Power believe that the 10.5 percent rate of return on common equity for the environmental surcharge is reasonable? Explain the response, and include any analyses or evaluations supporting its conclusions.

b. If no to part (a), what rate of return on common equity does Kentucky Power propose for its environmental surcharge? Provide a detailed analysis and testimony supporting Kentucky Power's position.

14. KRS 278.183(3) provides that during the 2-year review, the Commission shall, to the extent appropriate, incorporate surcharge amounts found just and reasonable into the existing base rates of the utility. In Case No. 2005-00341, the

approved Settlement Agreement provided that \$28,106,683 from the environmental surcharge was incorporated into Kentucky Power's base rates.

a. Does Kentucky Power believe any additional surcharge amounts need to be incorporated into its base rates in conjunction with this 2-year review?

b. If yes to part (a), provide the additional surcharge amount that Kentucky Power believes should be incorporated into its existing base rates. Explain how the surcharge amount should be incorporated into the base rates. Include all supporting calculations, workpapers, and assumptions as well as any analysis that Kentucky Power believes supports its position.

Billing Period July 1, 2005 through December 31, 2005

15. Refer to ES Form 3.14, Gavin Scrubber Costs, for the May 2005 expense month. Explain why scrubber maintenance costs were lower for May as compared to the scrubber maintenance costs reported for January through August 2005.

16. In Case No. 1996-00489, the Commission ordered that Kentucky Power's weighted average cost of capital would be reviewed and re-established during the 6-month review case. Provide the following information as of December 31, 2005:

a. The outstanding balances for long-term debt, short-term debt, accounts receivable financing, and common equity.

b. The blended interest rates for long-term debt, short-term debt, and accounts receivable financing. Include all supporting calculations showing how these blended interest rates were determined.

c. Kentucky Power's calculation of its weighted average cost of capital for environmental surcharge purposes.

17. Provide the following information concerning Kentucky Power's inventories of SO₂ and NO_x emission allowances:

a. The number of emission allowances in the ending inventory balances as of December 31, 2005. This ending inventory balance should reflect all available past vintage years of emission allowances through the 2005 vintage year.

b. For each year in the period 2006 through 2016,

(1) Indicate the number of emission allowances allocated or expected to be allocated by the Environmental Protection Agency for the Big Sandy generating units.

(2) Indicate the number of emission allowances estimated to be allocated to Kentucky Power under the Interim Allowance Agreement or other allocation mechanism.

(3) Indicate the number of emission allowances Kentucky Power estimates it will utilize in conjunction with the operation of the Big Sandy generating units. Reflect the changes resulting from the adoption of the Clean Air Interstate Rule.

(4) If available, indicate any other estimated additions or withdrawals of emission allowances from the Kentucky Power inventories of emission allowances. Include a description of the type of addition or withdrawal.

18. Through the end of 2016, does Kentucky Power plan on achieving SO₂ and NO_x emission limit compliance for the Big Sandy generating units only through the operation of currently in service emission control equipment and the consumption of emission allowances? If no, describe Kentucky Power's current plans for SO₂ and NO_x emission limit compliance at Big Sandy through the end of 2016.