

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. 2016-00109
POWER COMPANY FOR THE SIX-MONTH	)	
BILLING PERIOD ENDING DECEMBER 31, 2015	)	

**Motion for Partial Rehearing of the Commission's  
September 28, 2016 Order**

Kentucky Power Company respectfully moves the Public Service Commission of Kentucky pursuant to KRS 278.400 for partial rehearing of the Commission's September 28, 2016 Order. In particular, Kentucky Power seeks rehearing of the Commission's decision prohibiting the application of the environmental surcharge factor ("Factor") in effect through June 21, 2015 to costs incurred prior to June 22, 2015. Respectfully, that is an error.

The September 28 Order is contrary to the Commission's precedent and directives regarding the timing of changes to environmental surcharge tariffs. Rehearing is appropriate where, as here, a Commission's Order is in error.<sup>1</sup>

The rule is clear: when a Commission Order approves a change to Tariff E.S., it creates a bright line.<sup>2</sup> On one side of the line, environmental costs incurred prior to the date of the approval order must be recovered through the old Tariff E.S. On the other side, environmental costs incurred after the approval must be recovered through the new tariff. The confusion leading to the error in

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<sup>1</sup> Order, *In The Matter Of: Application Of Kentucky-American Water Company For A Certificate Of Public Convenience And Necessity Authorizing Construction Of The Northern Division Connection* at 7, Case No. 2012-00096, (Ky. P.S.C., January 23, 2014).

<sup>2</sup> Order, *In The Matter Of: 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* at 25, Case No. 2006-00307 (Ky. P.S.C. January 24, 2007).

the Company's initial interpretation of the change in Tariff E.S. and in the Commission Order is likely the result of the timing – the two-month lag – between the date the environmental costs are incurred and when they are billed.

The two-month lag inherent in the operation of Tariff E.S. creates a situation where the customer continues to receive bills utilizing a Factor based on the old Tariff E.S. for two months following the change in the tariff. The Commission's Order in this case does not reflect the proper application of its precedent concerning the treatment of this lag, and the result is the under-recovery of \$3,556,085. Kentucky Power should be allowed to recover this under-recovery over the six months following the entry of the requested Order granting rehearing and approving the recovery.

#### STATEMENT OF THE CASE

##### 1. Kentucky Power's Environmental Surcharge Factor

Consistent with KRS 278.183, Kentucky Power recovers from its customers the Company's costs of "complying with the Federal Clean Air Act as amended and those federal, state, or local environmental requirements which apply to coal combustion wastes and by-products from facilities utilized for production of energy from coal in accordance with the utility's compliance plan..."<sup>3</sup> Kentucky Power recovers these costs through the application of an environmental surcharge factor in accordance with its Tariff E.S.

Under Tariff E.S., Kentucky Power is authorized to recover from its customers those costs for environmental projects incurred in a particular month that exceed the monthly base amount identified in the tariff; conversely, Kentucky Power credits the customer if the costs incurred in the month are less than that monthly base amount. There is, however, a two-month lag between when those costs are incurred (and recovery or credit is authorized) and when they are billed for recovery through the Factor.

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<sup>3</sup> KRS 278.183(1).

Generally, the Factor is calculated by dividing the amount that must be charged or credited for a specific expense month (the difference between actual costs incurred and the monthly base amount) by the revenue received by the Company during that expense month. If the Company must charge customers, the Factor is positive; if the Company must credit customers, the Factor is negative. For example, if actual costs incurred in January for environmental projects exceed the January base amount, the Factor necessary to recover the difference will be calculated in February (using the January difference between actual and base costs and January revenues) and appear on customers' bills in March.

2. The Stipulation and Settlement Agreement and Tariff E.S.

On October 7, 2013, the Commission approved, with limited modification, a Stipulation and Settlement Agreement in Case No. 2012-00578. The Stipulation and Settlement Agreement was executed by the Company, the Kentucky Industrial Utility Customers, Inc., and the Sierra Club, and resolved Kentucky Power's application to acquire an undivided fifty percent interest in the Mitchell Generating Station in Moundsville, West Virginia. The Stipulation and Settlement Agreement included the following provisions relating to the Company's operation of the environmental surcharge:

5. Effective January 1, 2014, the monthly Environmental Surcharge factor (Tariff E.S.) will be fixed and maintained at 0.00% until new base rates are set by the Commission. The revised Tariff E.S. is attached hereto as EXHIBIT 2.
6. When base rates are set in the Base Rate Case, all costs associated with the Mitchell Units 1 and 2 Flue Gas Desulfurization (FGD) equipment will be recovered through the environmental surcharge (Tariff E.S.) approved in the Base Rate Case, and excluded from base rates in the Base Rate Case. This collection mechanism shall continue at least until the Commission sets new base rates for a period commencing after June 30, 2020 that include these costs. The charges payable under the Environmental Surcharge to be submitted for approval in the Base Rate Case will be determined by first allocating the revenue requirement between full requirements wholesale customers and retail customers in the same manner that it is presently allocated. The retail share of the revenue requirement will then be allocated between residential and non-residential retail customers based upon their respective total

revenues. The Environmental Surcharge will be implemented as a percentage of total revenues for the residential class and as a percentage of non-fuel revenues for all other customers.<sup>4</sup>

Exhibit 2 to the Stipulation and Settlement Agreement, the Company's revised Tariff E.S.

("Stipulation Tariff E.S.") provided:

In accordance with the Stipulation and Settlement Agreement approved by the Commission by its Order dated \_\_\_\_\_, 2013<sup>5</sup> in Case No. 2012-00578, the Monthly Factor will be fixed and maintained at 0.00% until new base rates are first established by the Commission after the effective date of this tariff without regard to the calculation of this Monthly Factor under paragraphs 1 through 4 below. Coincident with the first establishment of new base rates after the effective date of this tariff, the retail share of the revenue requirement associated with this tariff will then be allocated between residential and non-residential retail customers based upon their respective total revenues. The Environmental Surcharge will be implemented as a percentage of total revenues for the residential class and as a percentage of non-fuel revenues for all other customers.<sup>6</sup>

The Stipulation and Settlement Agreement thus included three changes to the manner in which the Company implemented its environmental surcharge mechanism:

- Beginning on January 1, 2014 and ending when new base rates are first established after the Company's next base rate case, the Company's Factor shall be set to zero;
- Coincident with the establishment of new base rates in the Company's next base rate case, the Factor will be calculated as a percentage of non-fuel revenues for non-residential customers; and
- When base rates are set in the next base rate case, all costs associated with the Mitchell FGD will be excluded from base rates and recovered solely through Tariff E.S.

Each of these provisions is tied in whole or part to the date the Commission sets new base rates in the Company's next base rate case: the use of non-fuel revenues in calculating the factor for non-

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<sup>4</sup> Order, *In The Matter Of: The 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*, Appendix A at 6-7, Case No. 2012-00578 (October 7, 2013) ("Stipulation and Settlement Agreement") (emphasis added).

<sup>5</sup> Upon entry of the Order Approving the Stipulation and Settlement Agreement, October 7, 2013 was added to the Stipulation Tariff E.S. language.

<sup>6</sup> Stipulation and Settlement Agreement, Exhibit 2 (emphasis added).

residential customers; the recovery of the Mitchell FGD costs through the environmental surcharge; and the date after which previously incurred costs are no longer subject to the zero rate.

3. Operation of Tariff E.S. Following the Stipulation and Settlement Agreement

As required by the Stipulation and Settlement Agreement, Kentucky Power set the Factor at zero beginning with the January 2014 billing month. In the periodic environmental surcharge reviews conducted by the Commission following January 1, 2014, the Commission confirmed the zero surcharge factor would continue to be applied to expenses incurred prior to the Commission Order changing the zero rate:

- Beginning January 1, 2014, Kentucky Power's environmental surcharge billing factor will be zero percent, per the terms of Settlement agreement in Case No. 2012-00578, and is to remain at that level until changed by the Commission.<sup>7</sup>
- Pursuant to the terms of the Settlement Agreement in Case No. 2012-00578 and the Commission's Order in Case No. 2013-00325, Kentucky Power's environmental surcharge billing factor will remain at zero percent until changed by the Commission.<sup>8</sup>
- Pursuant to the terms of the Settlement Agreement in Case No. 2012-00578 and the Commission's Order in Case No. 2013-00325, Kentucky Power's environmental surcharge billing factor will remain at zero percent until changed by the Commission.<sup>9</sup>

On December 23, 2014, Kentucky Power filed an application for an adjustment of general rates ("2014 Rate Case"). The 2014 Rate Case was the first general rate case filed by Kentucky Power following the approval of the Stipulation and Settlement Agreement. In the 2014 Rate Case,

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<sup>7</sup> Order, *In The Matter Of: 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* at 8, Case No. 2013-00325 (Ky. P.S.C. April 29, 2014) (emphasis added).

<sup>8</sup> Order, *In The Matter Of: An Examination By The Public Service Commission Of The Environmental Surcharge Mechanism Of Kentucky Power Company For The Six-Month Billing Period Ending December 31, 2013* at 6, Case No. 2014-00052 (Ky. P.S.C. August 22, 2014) (emphasis added).

<sup>9</sup> Order, *In The Matter Of: 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, 2014* at 6, Case No. 2014-00332 (Ky. P.S.C. March 6, 2015) (emphasis added).

Kentucky Power sought approval of a revised Tariff E.S. (“Rate Case Tariff E.S.”) which implemented provisions of the Stipulation and Settlement Agreement by:

- Removing the zero Factor;
- Changing the calculation methodology for the non-residential Factor; and
- Recovering all costs associated with the Mitchell FGD through Tariff E.S. and not base rates.

By order dated June 22, 2015 (“Rate Case Order”), the Commission approved the Rate Case Tariff E.S. for service rendered on or after that date.<sup>10</sup> Kentucky Power initially misinterpreted the Rate Case Order to require it to cease applying the Zero factor coincident with the effective date of new base rates. The effect of this erroneous interpretation was to apply a rate not in effect at the time the expenses were incurred. Upon further analysis, and consistent with the standard environmental surcharge review case data request asking the Company to identify any additional under-recovery or over-recovery, Kentucky Power believes failing to apply the zero rate – which was the rate in effect when the costs were incurred and revenues were received – is inconsistent with Commission precedent and directives regarding implementation of changes in Tariff E.S.

Accordingly, the Company respectfully requests that the Commission grant rehearing and allow the Company to recover the \$3.5 million it credited to customers by failing to apply the zero Factor.

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<sup>10</sup> Order, *In the Matter of: Application of Kentucky Power Company For: (1) A General Adjustment Of Its Rates For Electric Service; (2) An Order Approving Its Environmental Compliance Plan; (3) An Order Approving Its Tariffs And Riders; And (4) An Order Granting All Other Required Approvals And Relief* at 82, Case No. 2014-00396 (Ky. P.S.C. June 22, 2015).

## ARGUMENT

### The Commission's Interpretation of the Stipulation and Settlement Agreement is Inconsistent with Its Prior Treatment of Changes in Tariff E.S.

Commission precedent makes clear that the date it approves a change in Tariff E.S. is a bright line: environmental project costs incurred by the Company before that date are to be recovered pursuant to the old Tariff E.S., and those incurred after that date are to be recovered pursuant to the new Tariff E.S.<sup>11</sup> Again, recovery of those costs is subject to a two-month lag, but the Factor utilized to recover those costs is the Factor calculated using the tariff in place during the expense month when the costs are incurred.

Case No. 2006-00307 unmistakably established this precedent. There, Kentucky Power sought to amend its approved environmental compliance plan and associated Tariff E.S. The Company proposed that the amended Tariff E.S. become effective for bills rendered on or after a specific date, not for service rendered after that date. The Commission, recognizing the prohibition against retroactive ratemaking, disagreed:

The Commission finds that the E.S. tariff should become effective for service rendered on or after the date of this Order. The Commission will not make the revised E.S. tariff effective for bills rendered on or after the date of this Order *because doing so would result in retroactive ratemaking by requiring customers to pay for increases in environmental costs prior to the approval of those increases.*<sup>12</sup>

Although the Commission's Order refers to increases, the prohibition against retroactive ratemaking is equally applicable to any change in the rate.<sup>13</sup> By rejecting the Company's proposal in Case No. 2006-00307 to make the new Tariff E.S. effective for bills rendered after the date of the Order, the Commission created the bright line rule where costs incurred prior to the date the Commission

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<sup>11</sup> Order, *In The Matter Of: 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* at 25, Case No. 2006-00307 (Ky. P.S.C. January 24, 2007).

<sup>12</sup> *Id.* (emphasis supplied).

<sup>13</sup> See *Cincinnati Bell Tel. Co. v. Kentucky Pub. Serv. Com'n*, 223 S.W.3d 829, 839 (Ky. App. 2007).

approves a change to Tariff E.S. are recovered via the old Tariff E.S. and those incurred after are recovered via the new tariff.

Because of the two-month lag in billing, the customer will continue to see bills reflecting a Factor calculated under the old Tariff E.S. for two months after the approval of the new tariff. But the timing of collection does not affect the Factor to be used to collect the costs.

When it issued the Rate Case Order, the Commission established a bright-line date of June 22, 2015. The costs associated with the \$3.5 million under-recovery were not only incurred prior to the bright line, but while the zero rate was in effect. It is only for expenses incurred on or after June 22, 2015 that the Factor changed and those costs were to be recovered via the mechanism set forth in the Rate Case Tariff E.S. As the Commission recognized in Case No. 2006-00307, the application of an environmental surcharge rate not in effect when the expenses were incurred constitutes retroactive ratemaking.

Moreover, requiring the Company to change the Factor used to recover costs incurred prior to June 22, 2015 is inconsistent with the Commission's directives in the Company's three zero factor environmental surcharge review cases. In each, the Commission mandated that Kentucky Power keep the Factor at zero "until changed by the Commission."<sup>14</sup> The Commission did not change the Factor until it issued the Rate Case Order on June 22, 2015. Prior to that date, including the period during which the environmental expenses associated with the under-recovery were incurred, the zero rate was in effect. Accordingly, the zero rate is applicable to all costs incurred prior to June 22, 2015 whenever billed by Kentucky Power.

As the Commission recognized in Case No. 2006-00307, changes to the environmental surcharge rate are to be implemented only after the two-month delay in collection of the charges in

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<sup>14</sup> Order, Case No. 2013-00325 at 8; Order, Case No. 2014-00052 at 6; Order, Case No. 2014-00332 at 6.

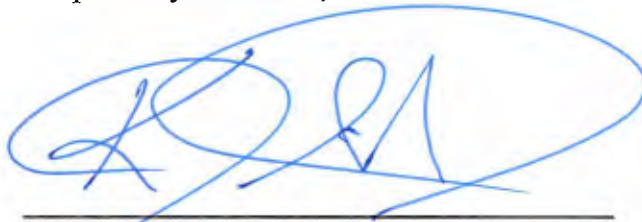


effect prior to the change. As a result, Kentucky Power's Factor reflected on bills should not have changed on the date the Commission issued the Rate Case Order.

Although the complexities associated with coordinating the proration based on the date service was rendered and implementing the two-month lag led to the Company's error in its initial filing, the date the costs incurred prior June 22, 2015 were billed is irrelevant. The prohibition against retroactive ratemaking requires that the rate in effect when those costs were incurred – the zero factor – be used in connection with the billing of those costs.

For the foregoing reasons, Kentucky Power respectfully requests that the Commission grant rehearing and authorize the recovery of the under-recovery of \$3,556,085 over the six months following the entry of the requested Order granting rehearing and approving the recovery.

Respectfully submitted,



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