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 TWO-YEAR BILLING PERIOD ENDING JUNE 30, 2009	)))))	CASE NO. 2009-00316

O R D E R

On August 18, 2009, the Commission initiated a two-year review of Kentucky Power Company's ("Kentucky Power") environmental surcharge as billed to customers for the two-year period July 1, 2007 through June 30, 2009.[1] Pursuant to KRS 278.183(3), the Commission must, at six-month intervals, review the past operations of the environmental surcharge, disallow any surcharge amounts that are not just and reasonable, and reconcile past surcharge collections with actual costs recoverable. At two-year intervals, the Commission must review and evaluate the past operations of the environmental surcharge, disallow improper expenses, and, to the extent appropriate, incorporate surcharge amounts found just and reasonable into the existing base rates of the utility.

The Commission issued a procedural schedule on August 18, 2009 that provided for discovery, the filing of prepared testimony, an informal conference, and a public

[1] Kentucky Power's surcharge is billed on a two-month lag. Thus, surcharge billings for June 2009 recover costs incurred in April 2009, and every subsequent monthly surcharge billing under review recovers costs incurred two months prior to billing.

hearing. Kentucky Power filed prepared direct testimony and responded to requests for information. There were no parties requesting intervenor status to this proceeding. On November 20, 2009, Kentucky Power filed a response to the Commission's November 19, 2009 Order, stating that there were no material issues of fact that warranted a hearing in this case. Kentucky Power further stated that this case may be submitted for decision on the current record without a hearing.

SURCHARGE ADJUSTMENT

The August 18, 2009 Order initiating this case indicated that, since each of the periods 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 determined that it had a net over-recovery of its environmental costs in the amount of $85,082.[2] Kentucky Power proposed that the net over-recovery be refunded by decreasing the total jurisdictional environmental surcharge amount by a one-time adjustment of $85,082 in its first monthly surcharge filing following the Commission's decision in this proceeding.[3]

The Commission has reviewed and finds reasonable Kentucky Power's calculation of a net over-recovery of $85,082 for the review period covered in this

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[2] Wagner Direct Testimony at 6 and 7 and Response to the Commission Staff's First Data Request dated September 10, 2009, Item 1, page 2 of 50.

[3] Id.

proceeding. The Commission also finds reasonable Kentucky Power's proposal to refund the over-recovery amount by a one-time adjustment of $85,082 in its first monthly surcharge filing following the date of this Order.

SURCHARGE ROLL-IN

Kentucky Power does not propose to incorporate, or "roll-in," any of its environmental surcharge into existing base rates. Kentucky Power states that it does not believe additional amounts of the environmental surcharge need to be rolled into existing base rates.[4] Kentucky Power contends that, whether there was a roll-in or not, the effect on the ratepayers is the same. Kentucky Power notes that its environmental costs represent both capital costs, which are normally reflected in demand charges, and operating and maintenance costs, which are normally reflected in energy charges. Kentucky Power argues that the best time to properly allocate or assign these different types of environmental costs is at the time of a base rate case.[5]

The environmental surcharge statute directs the Commission to incorporate surcharge amounts found just and reasonable into the utility's existing base rates, but only "to the extent appropriate." The Commission agrees with Kentucky Power that, whether or not there is a roll-in, ratepayers' total bills will be the same. The Commission also agrees that, due to the potential need to revise demand charges to reflect the environmental capital costs, it is reasonable not to incorporate the environmental surcharge into existing base rates in this case.

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[4] Response to the Commission Staff's First Data Request dated September 10, 2009, Item 5.

[5] Id.

RATE OF RETURN

In Case No. 1996-00489,[6] the Commission found that Kentucky Power's debt portion of its weighted average cost of capital should be reviewed and reestablished during each six-month review case. 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 for Kentucky Power's environmental compliance rate base.[7]

Kentucky Power states that it believes the 10.50-percent rate of return on common equity established in the settlement agreement in Case No. 2005-00341[8] is the reasonable rate of return for environmental surcharge purposes. Kentucky Power provided the outstanding balances for its long-term debt, short-term debt, accounts receivable financing, and common equity as of April 30, 2009, the last expense month of the review periods. It also provided the blended interest rates for the long-term debt, short-term debt, and accounts receivable financing as of April 30, 2009.[9] Using this information, Kentucky Power calculated a weighted average cost of capital, before

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[6] Case No. 1996-00489, Kentucky Power Company d/b/a American Electric Power (Ky. PSC May 27, 1997).

[7] 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.

[8] Case No. 2005-00341, Kentucky Power Company (Ky. PSC Mar. 14, 2006).

[9] Response to the Commission Staff's Informal Conference Data Request dated October 16, 2009, Item 1.

income tax gross-up, of 7.13 percent.[10] Kentucky Power also provided the weighted average cost of capital reflecting the tax gross-up approach approved in Case No. 2005-00068.[11]

The Commission has reviewed Kentucky Power's determination of its weighted average cost of capital and finds the 7.13 percent to be reasonable. The Commission has also reviewed the determination of the tax gross-up factor and finds that it is consistent with the approach approved in Case No. 2005-00068. Therefore, the Commission finds that the weighted average cost of capital of 7.13 percent and the income tax gross-up factor of 1.5760 should be used in all monthly environmental surcharge filings subsequent to the date of this Order.[12]

IT IS THEREFORE ORDERED that:

1. Kentucky Power shall reduce its jurisdictional environmental revenue requirement determined in the first billing month following the date of this Order by $85,082 as discussed herein.

2. Kentucky Power shall use a weighted average cost of capital of 7.13 percent and a tax gross-up factor of 1.5760 in all monthly environmental surcharge filings subsequent to the date of this Order.

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[10] Id.

[11] Case No. 2005-0068, Kentucky Power Company (Ky. PSC Sep. 7, 2005).

[12] Response to the Commission Staff's Informal Conference Data Request dated October 16, 2009, Item 1. In the response, Kentucky Power determined that the income tax gross-up factor was 1.5760, which would produce a tax grossed-up weighted average cost of capital of 9.52 percent.

By the Commission

Commissioner Borders abstains.

ENTERED

JAN 20 2010

KENTUCKY PUBLIC SERVICE COMMISSION

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