

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	)	2016-00109
BILLING PERIOD ENDING DECEMBER 31, 2015	)	

ORDER

On March 11, 2016, 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, 2015, to December 31, 2015.<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.

The Commission issued a procedural schedule on March 11, 2016, that provided for discovery, the filing of prepared testimony, and intervenor testimony. Kentucky Power filed prepared testimony, and responded to two requests for information from Commission Staff. There were no intervention requests in this proceeding. On July 12,

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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 2015 through December 2015 are based on costs incurred from May 2015 through October 2015.

2016, an informal conference ("IC") was held at the Commission's offices to discuss the issues in this case. On July 25, 2016, Kentucky Power responded to Staff's IC requests for information and filed a motion that this case be submitted for decision by the Commission based on the existing record. Because 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

During the review period, a misclassification of certain accounts used in calculating the retail allocation percentage caused an over-collection of \$75,542. Kentucky Power included a \$75,542 adjustment to correct the over-collection in the February 2016 expense month, which is outside of this review period.

Kentucky Power did not propose any additional over- or under-recovery for the review period.<sup>3</sup> Kentucky Power states that the average residential customer's monthly usage for this review period was 1,387 kilowatt hours.<sup>4</sup> Because Kentucky Power did not propose any additional over- or under-recovery for the review period, there would be no additional impact on an average residential customer's bill. 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.

#### RATE OF RETURN

In previous environmental surcharge reviews, the Commission has been guided by its findings in Case No. 1996-00489 with respect to the determination of the weighted

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<sup>3</sup> Kentucky Power's Response to Commission Staff's First Request for Information ("Staff's First Request"), Item 1.

<sup>4</sup> Kentucky Power's Response to Staff's First Request, Item 8.

average cost of capital (“WACC”) to be used prospectively in Kentucky Power’s monthly environmental surcharge filings. However, the Settlement Agreement in Case No. 2014-00396<sup>5</sup> now supersedes the findings in Case No. 1996-00489. The Settlement Agreement authorized a return on common equity of 10.25 percent for environmental surcharge purposes.<sup>6</sup> It also specified that Kentucky Power utilize a WACC of 7.34 percent and a gross revenue conversion factor of 1.616424 to be applied to the return on equity, which would remain constant until changed by the Commission in Kentucky Power’s next base rate case.<sup>7</sup> The Settlement Agreement also authorized a gross-up factor of 1.004977 to be applied to the long- and short-term debt and accounts receivable financing weighted average cost percentages.<sup>8</sup> Together, these factors produce an overall rate of return of 10.128 percent. Therefore, the Commission finds that the combination of these components, which produces an overall grossed-up rate of return of 10.128 percent, should be used in all monthly environmental surcharge filings subsequent to the date of this Order.

#### 12-MONTH AVERAGE REVENUE

Kentucky Power currently uses the actual revenue from the expense month in the calculation of its environmental surcharge factor. Kentucky Power is proposing to use the average revenue of the preceding 12-month period. Kentucky Power claims

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<sup>5</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>6</sup> Case No. 2014-00396, *Kentucky Power Company*, Settlement Agreement, numbered paragraph 2 at 5.

<sup>7</sup> *Id.*, paragraph 3 at 5–6.

<sup>8</sup> *Id.*, Exhibit 2.

that the proposed change will better limit the month-to-month fluctuations of the surcharge factor, minimize the amounts over- or under-collected through the surcharge, and minimize the economic burden for Kentucky Power customers by reducing the effect of the surcharge calculated in lower-revenue months and applied to higher-revenue months.<sup>9</sup> Kentucky Power notes that all of Kentucky's other utilities with an environmental surcharge are currently utilizing this same methodology.<sup>10</sup> Kentucky Power proposes to implement this change in the first month following the Commission's Order in this proceeding.<sup>11</sup> The proposed change will require a modification to ES Form 3.32.<sup>12</sup> The Commission finds reasonable Kentucky Power's proposal to utilize a 12-month average revenue in the calculation of its environmental surcharge factor and the modification to ES Form 3.32.

#### EMISSION ALLOWANCE REPORTING FORMS

Kentucky Power is proposing changes to its monthly environmental surcharge report forms ES Form 3.11 and ES Form 3.12 to separately report current and non-current emission allowances. Kentucky Power states that the Federal Energy Regulatory Commission "requires that only allowances that may be consumed in the year of the calculation be included in the average cost calculations used to determine consumption expense."<sup>13</sup> Non-current allowances can only be consumed in future compliance years. Presently, Kentucky Power includes non-current allowances in the

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<sup>9</sup> Direct Testimony of Amy J. Elliott at 5.

<sup>10</sup> *Id.* at 4.

<sup>11</sup> *Id.* at 5.

<sup>12</sup> *Id.* at 4–5.

<sup>13</sup> Kentucky Power's Response to Commission Staff's Second Request for Information, Item 7.c.

total inventory but not in the calculation of average cost. The proposed change would separate current and non-current allowances in the reported inventory to “synchronize the reported and recorded average costs.”<sup>14</sup> Kentucky Power contends that the proposed change will have no effect on the calculation of its environmental surcharge.<sup>15</sup> The Commission finds reasonable Kentucky Power’s proposed changes to its emission allowance reporting.

#### PRORATION OF THE BILLING FACTOR

The Final Order in Case No. 2014-00396 was issued on June 22, 2015, and approved revisions to Kentucky Power’s Environmental Surcharge Tariff (“Tariff E.S.”) for service rendered on and after that date. Because Kentucky Power’s environmental surcharge is billed on a two-month lag and applied over 21 billing cycles, bills rendered between August 21, 2015, and September 18, 2015, contained an environmental surcharge factor prorated between factors calculated in accordance with two versions of Tariff E.S. Customer bills were generated using billing factors that were prorated based on the number of days in the billing cycle and modified in Kentucky Power’s billing system daily.<sup>16</sup> Having reviewed the record, the Commission finds reasonable Kentucky Power’s calculation and use of the prorated environmental surcharge billing factors. The proration of the billing factor is unrelated to the discussion of the appropriate billing factors to be used for the expense months of May–July 2015 and has no impact on determining the proper billing factor to be used for these months.

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<sup>14</sup> *Id.*, Item 4.c.

<sup>15</sup> *Id.*

<sup>16</sup> Kentucky Power’s Response to Staff’s First Request, Item 10.

## APPLICABLE FACTOR FOR THE MAY–JULY 2015 EXPENSE MONTHS

The Stipulation and Settlement Agreement (“Settlement Agreement”) in Case No. 2012-00578<sup>17</sup> set Kentucky Power’s environmental surcharge billing factor at zero percent effective January 1, 2014, until new base rates were set by the Commission (“Stipulation period”). The Settlement Agreement does not expressly dictate whether the Stipulation period should begin or end on either a billing- or expense-month basis; however, Case No. 2013-00325<sup>18</sup> ordered that the zero factor be applied to January 2014 bills, which effectively required that it would start on a billing-month basis. Kentucky Power agreed with this approach in its responses to information requests and the fact that it billed the surcharge consistent with the understanding that the zero factor would be applied to the January billing month. Additionally, Kentucky Power asserted, “[t]o be consistent, when the Stipulation period has ended and assuming new base rates are to be effective July 2015, the expense month of May 2015 will be used for the ES calculation.”<sup>19</sup> The end of the Stipulation period was not specifically addressed elsewhere in Case Nos. 2012-00578 or 2013-00325. However, nothing in these two cases suggests that the Stipulation period would end on an expense-month basis.

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<sup>17</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 Nov. 22, 2013).

<sup>18</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>19</sup> Case No. 2013-00325, *Kentucky Power's Response to Commission Staff's Second Request for Information* (filed Dec. 11, 2013), Item 2.

With the issuance of the Final Order in Case No. 2014-00396, Kentucky Power's base rates were established for service rendered on and after June 30, 2015, and the environmental surcharge billing factor was no longer set at zero percent effective with the July billing month. The revisions to Tariff E.S. approved in Case No. 2014-00396 was approved for service on and after June 22, 2015, and accordingly could not be billed to customers until August 21, 2015, because of the two-month lag in Kentucky Power's environmental surcharge. Therefore, the environmental surcharge billing factor should not have been zero percent or calculated under the revised Tariff E.S. approved in Case No. 2014-00396 for environmental expenses incurred under the prior version of Tariff E.S. and recovered from June 30, 2015, through August 20, 2015.

Before new base rates were set in Case No. 2014-00396, Kentucky Power calculated the environmental surcharge billing factor in accordance with the version of Tariff E.S. approved in Case No. 2012-00578, but billed the factor at zero percent in accordance with the Settlement Agreement in Case No. 2012-00578. For the expense months of May through July 2015, Kentucky Power calculated and billed the environmental surcharge billing factor in accordance with the version of Tariff E.S. approved in Case No. 2012-00578. At the IC, Kentucky Power stated it was not sure whether the May through July expense month billing factors should have remained set at zero percent, or if non-zero factors should have been determined and billed.

As a result of questions raised by Kentucky Power at the IC, Staff requested that Kentucky Power recalculate the May through July 2015 expense months utilizing a zero percent billing factor, which produced an under-recovery of \$3,556,085 for the review

period.<sup>20</sup> Kentucky Power proposed to collect this under-recovery over a six-month period.<sup>21</sup>

In support, Kentucky Power proffered its response to Commission Staff's Third Request for Information, Item 53, in Case No. 2014-00396 as demonstration of its intent to use the zero factor until new rates were effective.<sup>22</sup> However, in that response, Kentucky Power's example utilizes the new rates for bills rendered on and after June 22, 2015.<sup>23</sup> This response demonstrates the use of a zero factor until new rates are billed but results in retroactive ratemaking.<sup>24</sup>

Kentucky Power also suggests that the Commission's decision in Case No. 2013-00325 to disallow the collection of the under-recovery for the September and October 2013 expense months which was included in the November and December 2013 monthly environmental surcharge reports is evidence that the Stipulation period should have ended with the expense month of July.<sup>25</sup> However, as discussed above, Case No. 2013-00325 effectively required that the Stipulation period would begin on a billing-month basis. The under-recovery for September and October 2013 was

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<sup>20</sup> Kentucky Power's Response to Commission Staff's Informal Conference Request for Information ("Staff's IC Request"), Item 1.

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> Case No. 2014-00396, *Kentucky Power Company* Response to Commission Staff's Third Request for Information (filed Mar. 9, 2015), Item 53, Attachment 1.

<sup>24</sup> See 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), Order at 16. "The Commission will not make the revised E.S. tariff effective for bills rendered on and 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>25</sup> Kentucky Power's Response to Staff's IC Request, Item 1.

disallowed because the Stipulation period began with the January 2014 billing month, and as such, the environmental surcharge was to be zero percent on January bills, which reflected the November 2013 expense month. Additionally, Kentucky Power stated that the May 2015 expense month would be used to calculate the environmental surcharge billing factor if new rates were set in July 2015.

Kentucky Power further provides that the “use of an environmental surcharge factor other than zero during the expense months the rate was required by the Stipulation and Settlement Agreement to be maintained at zero similarly would contravene the terms of the agreement.”<sup>26</sup> While this statement is technically correct, the Stipulation period in fact ended with the billing period in which new rates were set by the Commission, and therefore, the expense months of May through July 2015 were outside the Stipulation period. Therefore, Kentucky Power properly billed the environmental surcharge at zero percent until the end of the Stipulation period. The Commission concurs with the as-filed billing factors for the expense months of May through July 2015. The Commission has reviewed Kentucky Power’s determination that it would have an under-recovery of \$3,556,085 for the review period utilizing a zero percent factor for the expense months of May to July 2015. For the reasons stated above, the Commission finds the under-recovery unreasonable and does not agree with Kentucky Power's proposal to collect the under-recovery in the six months following the issuance of an Order in this matter.

Having reviewed the record, the Commission finds reasonable Kentucky Power's as-filed calculation of the surcharge factor for the expense months of May through July

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<sup>26</sup> *Id.*

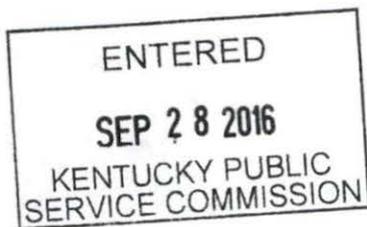
2015 in accordance with the version of Tariff E.S. approved in Case No. 2012-00578, subject to the proration discussed above.

IT IS THEREFORE ORDERED that:

1. Kentucky Power's request to submit this case for a decision on the existing evidence of record without a hearing is granted.
2. The environmental surcharge amounts determined by Kentucky Power for the review period July 1, 2015, through December 31, 2015, are just and reasonable.
3. Kentucky Power's determination that it had no additional over- or under-recovery for the review period is approved.
4. Kentucky Power's determination that it had an under-recovery of \$3,556,085 for the review period is denied and, it shall not collect the under-recovery of \$3,556,085 in the first six months subsequent to the date of this Order.
5. 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 until further order of the Commission.
6. Kentucky Power's proposal to utilize a 12-month average revenue in the calculation of its environmental surcharge factor is approved and shall begin in the first month subsequent to the date of this Order.
7. Kentucky Power's proposed changes to its environmental reporting formats, ES Form 3.11, ES Form 3.12, and ES Form 3.32, are approved and shall be used for all monthly environmental surcharge filings subsequent to the date of this Order.

8. Within 20 days of the date of this Order, Kentucky Power shall file with the Commission, using the Commission's electronic Tariff Filing System, revised tariffs reflecting the change described in paragraph 6 of this Order and a red-lined version of its tariffs.

By the Commission



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