

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 EAST KENTUCKY)	
POWER COOPERATIVE, INC. FOR THE)	CASE NO.
SIX-MONTH PERIOD ENDING DECEMBER 31,)	2014-00051
2013 AND THE PASS-THROUGH MECHANISM)	
FOR ITS SIXTEEN MEMBER DISTRIBUTION)	
COOPERATIVES)	

ORDER

On March 6, 2014, the Commission initiated a six-month review of East Kentucky Power Cooperative, Inc.'s ("EKPC") environmental surcharge¹ as billed to its member distribution cooperatives ("Member Cooperatives") for the six-month period of July 1, 2013, to December 31, 2013. Pursuant to KRS 278.183(3) the Commission must review, at six-month intervals, the past operations of the environmental surcharge; disallow any surcharge amounts that are found not to be just and reasonable; and reconcile past surcharges with actual costs recoverable pursuant to KRS 278.183(1).

¹ EKPC's environmental surcharge was initially approved in Case No. 2004-00321, *Application of East Kentucky Power Cooperative, Inc. for Approval of an Environmental Compliance Plan and Authority to Implement an Environmental Surcharge* (Ky. PSC Mar. 17, 2005).

The March 6, 2014 Order also initiated a six-month review of the 16 EKPC Member Cooperatives' pass-through mechanism² as billed to their retail member customers for the six-month period August 1, 2013, to January 31, 2014.³

The Commission issued a procedural schedule that provided for discovery, the filing of prepared testimony and intervenor testimony. EKPC filed prepared direct testimony and responded to two requests for information. The Member Cooperatives responded to four requests for information. Three informal conferences were held in the course of this proceeding. A formal public hearing was conducted on December 16, 2014. EKPC and the Member Cooperatives responded to a post-hearing data request. South Kentucky Rural Electric Cooperative Corporation filed a post-hearing brief. There were no parties requesting intervenor status to this proceeding.

SURCHARGE ADJUSTMENT

The March 6, 2014 Order initiating this case indicated that since the period under review in this proceeding may have resulted in over- or under-recoveries of allowable environmental compliance costs, the Commission would entertain proposals to adopt one adjustment factor to net all over- or under-recoveries. EKPC determined that it had

² Case No. 2004-00372, *Application of Big Sandy RECC, Blue Grass Energy Cooperative Corporation, Clark Energy Cooperative, Cumberland Valley Electric, Farmers RECC, Fleming-Mason Energy, Grayson RECC, Inter-County Energy Cooperative, Jackson Energy Cooperative, Licking Valley RECC, Nolin RECC, Owen Electric Cooperative, Salt River Electric, Shelby Energy Cooperative, South Kentucky RECC and Taylor County RECC for Authority to Pass Through the Environmental Surcharge of East Kentucky Power Cooperative, Inc.* (Ky. PSC Mar. 17, 2005).

³ The Settlement Agreement approved in Case Nos. 2004-00321 and 2004-00372 allows the member distribution cooperatives to pass through the environmental surcharge to their customers at approximately the same time as EKPC bills the environmental surcharge to the member distribution cooperatives, thus avoiding a billing lag for the member distribution cooperatives. The costs incurred in the months of June 2013 through November 2013 are billed to the member distribution cooperatives in the months of July 2013 through December 2013, with these same costs passed through to the member customers on the bills for August 2013 through January 2014.

no adjustments to its environmental costs for the period under review.⁴ The Commission has reviewed and finds reasonable EKPC's calculation of any over- or under-recovery for the review period covered in this proceeding and finds no need for any subsequent adjustments of EKPC's environmental costs as a result of its review.

RATE OF RETURN

The Settlement Agreement approved in Case No. 2004-00321 provided that the rate of return would be based on a weighted average debt cost of the debt issuances directly related to the projects in EKPC's compliance plan, multiplied by a Times Interest Earned Ratio ("TIER") factor. The Settlement Agreement further provided that EKPC update the return as of the end of each six-month review period and request Commission approval of the updated average cost of debt.⁵

EKPC updated the weighted average cost of debt as of November 30, 2013, and determined the rate of return utilizing a TIER factor of 1.50, which was authorized in Case No. 2011-00032.⁶ Utilizing these components, EKPC proposes an overall rate of return of 6.063 percent to be used starting with the first month following the final Order in this case.⁷

⁴ EKPC's Response to Commission Staff's First Request for Information ("Staff's First Request"), Item 1; and Direct Testimony of Isaac S. Scott (filed Apr. 4, 2014) ("Scott Testimony") at 6.

⁵ Case No. 2004-00321, *East Kentucky Power Cooperative, Inc.* (Ky. PSC Mar. 17, 2005), Order, Appendix A at 3.

⁶ Case No. 2011-00032, *An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of East Kentucky Power Cooperative, Inc. for the Six-Month Billing Period Ending December 31, 2010; and the Pass-Through Mechanism for Its Sixteen Member Distribution Cooperatives* (Ky. PSC Aug. 2, 2011).

⁷ EKPC's Response to the Staff's First Request, Item 5.

The Commission has reviewed and finds reasonable EKPC's determination of the updated rate of return, which reflects the updated weighted average cost of debt and a 1.50 TIER factor. The Commission finds that EKPC should use a rate of return of 6.063 percent for all environmental surcharge monthly filings submitted after the date of this Order.

RETAIL PASS-THROUGH MECHANISM

Retail Pass-Through Adjustment

The Member Cooperatives utilize the retail pass-through mechanism to bill their customers for environmental costs charged to them by EKPC. The basic operation of the retail pass-through mechanism will result in an over- or under-recovery of the environmental surcharge for each of the Member Cooperatives. The over- or under-recoveries experienced by the Member Cooperatives for this review period prompted proposals to change how the over/under-recovery amounts are determined for this review period and the calculation methodology to be used in future reviews. The current calculation methodology has been used since EKPC was granted approval for an environmental surcharge in 2005.

The proposed changes arise from the swings the Member Cooperatives experienced in the over/under-recovery amounts determined for this review period due to amortization of over/under amounts in previous reviews. Central to the issue was the

processing of review cases 2012-00486⁸ and 2013-00140⁹ in close proximity. The amortizations of the over/under-recoveries from those cases occurred during the current review case and thus impacted the calculation of each Member Cooperative's over/under amounts for this review period. The amortizations authorized in those cases reflected 24 months of surcharge operations, and because of the timing of the final Orders in the those cases, there was an overlap of amortization periods requiring amortization to be completed in seven months. As a result, the Member Cooperatives experienced swings from an over-recovery to an under-recovery or vice versa in this review period, some of which were significant in terms of the amounts involved.

The Member Cooperatives stated that it was because of the aforementioned swings in over-/under-recovery positions that the problem with the existing calculation methodology was brought to their attention, and they have concluded that the problem has always existed.¹⁰ The Member Cooperatives contend that the current method for determining their respective over/under-recovery amounts and the resulting swings from an over-recovery to an under-recovery or vice versa leave them in a situation in which amortization is never completely finished.¹¹ The Member Cooperatives stated this leads

⁸ Case No. 2012-00486, *An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of East Kentucky Power Cooperative, Inc. for the Two-Year Billing Period Ending June 30, 2011, for the Six-Month Billing Periods Ending December 31, 2011 and June 30, 2012, and the Pass Through Mechanism for Its Sixteen Member Distribution Cooperatives* (Ky. PSC Aug. 2, 2013).

⁹ Case No. 2013-00140, *An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of East Kentucky Power Cooperative, Inc. for the Six-Month Billing Period Ending December 31, 2012 and the Pass Through Mechanism for Its Sixteen Member Distribution Cooperatives* (Ky. PSC Sept. 17, 2013).

¹⁰ Supplemental Testimony of Isaac S. Scott (filed June 30, 2014) ("Scott Supplemental Testimony") at 5.

¹¹ *Id.*

to margin instability and higher environmental surcharge billing factors for cooperative customers.

The Member Cooperatives proposed to resolve this issue in two steps.¹² First, for this review period, each Member Cooperative would determine its over/under-recovery from the inception of EKPC's environmental surcharge in 2005 through the end of this review period.¹³ The resulting over/under-recovery amounts would be the amounts that the Commission finds reasonable to amortize. Second, the Member Cooperatives proposed that the format for determining their over/under amounts in future surcharge review periods be modified to remove the effects of amortization of prior review period over/under-recovery amounts in effect during the review period.¹⁴

The Member Cooperatives provided calculations of their respective over- or under-recovery positions since the inception of EKPC's environmental surcharge. On behalf of the Member Cooperatives, EKPC filed supplemental testimony in support of the "since inception" calculation to determine the over/under-recovery amounts for this review, stating that it would provide a more accurate indication of the true over/under-recovery for each cooperative.¹⁵ Other than testimony from EKPC on behalf of the Member Cooperatives and responses to information requests, the Member

¹² Scott Supplemental Testimony at 6.

¹³ *Id.* See also South Kentucky Rural Electric Cooperative's ("South Kentucky") Response to Staff's First Request, Item 2.b.

¹⁴ Scott Supplemental Testimony at 6. See also Farmers Rural Electric Cooperative's ("Farmers") Response to Staff's First Request, Item 2.b.

¹⁵ Scott Supplemental Testimony at 6.

Cooperatives were relatively silent on the “since inception” calculation. The “since inception” approach was the central issue of the December 16, 2014 Hearing, as it related to South Kentucky’s position. South Kentucky was the only cooperative to participate in the Hearing on this issue.

South Kentucky testified at the hearing that if the “since inception” proposal was not approved, and the proposed calculation methodology was approved for this review, It would have to write off approximately \$1.8 million dollars of environmental surcharge revenue and would need to file a rate case. The amount of the suggested write-off consisted of two components. The first component was \$881,647, which was the result of their calculation of their over-/under-recovery position since the inception of EKPC’s environmental surcharge through December 2013, the last month of this review period. The second component was \$852,912, which represents amortization amounts approved in Case Nos. 2012-00486 and 2013-00140 to be collected or refunded in the months following the end of this review. Due to the passage of time in this proceeding, South Kentucky has recovered the open amortization amounts of \$852,912, therefore, those amounts would not be subject to being written off and expensed on South Kentucky’s books. The following discussion addresses the first component of South Kentucky’s proposed write-off and lost revenues.

The “since inception” proposal conflicts with the provisions of the environmental surcharge statute and the prohibition against retroactively considering environmental surcharge operations that preceded the current two-year review period. As set forth and mandated by KRS 278.183(1), a utility may recover its current environmental compliance costs. Pursuant to KRS 278.183(3), the Commission reviews the operation

of each utility's environmental compliance mechanism at six-month intervals, culminating in a final two-year review of the past operation of the surcharge. Based on the statutory provisions, the Commission has limited alterations to a utility's environmental surcharge billings to those costs that occur within the current two-year window, as provided for by KRS 278.183.¹⁶

This review proceeding is the first six-month review of a new two-year review cycle. An Order was issued March 21, 2014 in Case No. 2013-00324¹⁷ that closed and finalized the previous two-year review period. Even though there are unique circumstances in this case stemming from the timing of the two previous review cases, the Commission finds that any proposed modification of previous environmental surcharge recoveries, if needed, were required to have been brought before the Commission during their respective previous six-month and two-year review proceedings. Accordingly, the Commission finds that the "since inception" proposal should be denied.

¹⁶ KRS 278.183 was modeled after the Commission's Fuel Adjustment Clause ("FAC") regulation, 807 KAR 5:056. Both KRS 278.183 and 807 KAR 5:056 provide for six-month and two-year reviews of past operations. The Commission has recently reaffirmed its standing practice that no adjustments or recovery are permitted outside of a two-year review period. See Case No. 2013-00261, *An Examination of the Application of the Fuel Adjustment Clause of Kentucky Power Company from November 1, 2012 through April 30, 2013* (Ky. PSC Nov. 22, 2013). The Franklin Circuit Court has also upheld this position through holding that while six-month Orders are subject to revision before becoming final at the end of a two-year review proceeding, upon closing, each two-year review becomes final and thus non-modifiable. *Kentucky Industrial Utility Customers, Inc. v. Kentucky Public Service Commission, Louisville Gas and Electric Company and Attorney General of the Commonwealth of Kentucky, by and through his Utility and Rate Intervention Division*, 201 P.U.R. 4th 381, 384 (Ky. Cir. Ct. 2000). While the holdings were set forth in FAC proceedings, the holdings apply equally to the environmental surcharge statute due to the similarity in its wording to that of the FAC regulation.

¹⁷ Case No. 2013-00324, *An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of East Kentucky Power Cooperative, Inc. for the Two-Year Billing Period Ending June 30, 2013 and the Pass Through Mechanism for Its Sixteen Member Distribution Cooperatives* (Ky. PSC Mar. 21, 2014).

With respect to the second step in the proposed solution aimed at alleviating the over/under-recovery swings, EKPC tendered testimony on behalf of the Member Cooperatives describing the modification to the existing format used to determine the over/under-recovery amounts for a review period.¹⁸ The goal of the proposed modification is to remove the effect of amortizing Commission-approved prior-review over/under-recovery amounts from the determination of the current review's over/under-recovery amount. This would be accomplished by netting any prior period over/under-recovery amount from the total environmental surcharge amount recovered, with the remaining amount compared to the environmental costs billed by EKPC to the Member Cooperative.¹⁹ EKPC provided a suggested format to be used to determine the over/under-recoveries, removing the effect of any amortization of previous review case over/under-recoveries.²⁰

The proposed modification to the determination of over/under amounts did not include an explanation of what happens to the difference in the amounts determined under both calculation methods, leaving the Commission concerned that Member Cooperative customers may not be properly billed for environmental costs. While EKPC filed testimony on behalf of the Member Cooperatives supporting the calculation modification, and all Member Cooperatives responded to information requests, only three Member Cooperatives — South Kentucky, Farmers, and Owen Electric

¹⁸ Scott Supplemental Testimony at 7-8.

¹⁹ At the informal conference held September 4, 2014, Staff proposed that any prior period's over/under-recovery amount be netted against the environmental costs billed by EKPC, which would then be compared to the amount recovered by the Member Cooperative. The parties generally agreed this would produce the same result as proposed by the Member Cooperatives.

²⁰ Scott Supplemental Testimony, Exhibit ISS-1.

Cooperative, Inc. (“Owen Electric”) — provided any response that clearly indicated their support for the proposed calculation format.²¹ Given that the proposed change will affect all Member Cooperatives, the Commission finds that an indication of full support for the change must be made evident, including an explanation of the disposition of over/under amounts determined using the current methodology, and the reasonableness of the proposed change. Therefore the Commission finds that the Member Cooperatives should continue with the current calculation methodology for this review. In a future review proceeding, the Member Cooperatives may propose revised methodology in accordance with the parameters discussed above.

For the reasons stated above, the Commission finds that the over/under-recovery amounts originally determined by the Member Cooperatives will be used for this review.²² Ten of the Member Cooperatives determined that they experienced an over-recovery and six of the Member Cooperatives experienced an under-recovery.²³ EKPC stated that the Member Cooperatives proposed that the over-recovery amounts or under-recovery amounts be amortized over a six-month period beginning in the first month after the Commission’s Order in this proceeding.²⁴ The Commission finds reasonable the Member Cooperatives’ proposals to amortize their respective accumulated over-/under-recovery amounts over a period of six months beginning in the first month after the Commission’s Order in this proceeding.

²¹ Farmers’ Response to Staff’s First Request, Item 2.b.; Brief of South Kentucky (filed Jan. 13, 2015); and Owen Electric’s Response to post-hearing data request, Item 12.

²² See Member Cooperatives’ Responses to Staff’s First Request, Item 2.a.

²³ *Id.*

²⁴ Scott Testimony at 7.

A schedule of the over- or under-recovery for each Member Cooperative and the related monthly adjustments is shown in the Appendix to this Order. The impact of the over- or under-recovery on an average residential customer's monthly bill for each respective Member Cooperative is also indicated.

OTHER ISSUES

During discovery it was determined that two cooperatives use multiple billing factors in a revenue month to bill their share of EKPC's environmental costs to their customers. This scenario could result in customers with identical usage being billed different environmental surcharge amounts within the same month, which is not justifiable for the customer that has a higher billing factor. Shelby Energy Cooperative ("Shelby") agreed to discontinue this practice and proposed to transition to a single billing factor in November 2014. The Commission has reviewed Shelby's proposal and finds that Shelby should make the change as proposed. Fleming-Mason Energy Cooperative, Inc. ("Fleming-Mason") stated that its accounting month ends at mid-month, which is unusual. Typically an accounting month and calendar month coincide. In Fleming-Mason's case even if two billing factors are used in a calendar month, the revenue or accounting month's billing factor will be the same. The Commission therefore feels that no changes are necessary for Fleming-Mason.

IT IS THEREFORE ORDERED that:

1. The amounts billed by EKPC through its environmental surcharge for the period July 1, 2013, to December 31, 2013, are approved.

2. EKPC shall use a rate of return of 6.063 percent in all monthly environmental surcharge filings subsequent to the date of this Order.

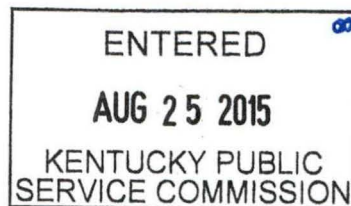
3. EKPC's Member Cooperatives shall include the applicable monthly retail pass-through adjustments, shown in the Appendix to this Order, in the determination of each Member Cooperative's respective pass-through mechanism in each of the first six months following the date of this Order, as discussed herein.

4. EKPC's Member Cooperatives' request to alter their retail pass-through mechanism's over/under calculations is denied.

5. EKPC's Member Cooperatives' request to use the "since inception" method to calculate their over/under amount for this review is denied.

6. Shelby Energy's proposal to transition to a single environmental surcharge factor in a revenue month is approved.

By the Commission



ATTEST:


Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE
COMMISSION IN CASE NO. 2014-00051 DATED **AUG 25 2015**

Member Cooperatives' Adjustment to
Monthly Pass-Through Mechanism

The EKPC Member Cooperatives shall include the following monthly adjustments in the determination of the applicable pass-through factors for the first six months after the date of this Order.

	<u>Total Amount of Over Recovery</u>	<u>Monthly Amount To Be Returned</u>	<u>Monthly Bill Impact</u>
Big Sandy RECC	\$90,404	\$15,067	\$0.90
Clark Energy Cooperative	\$252,493	\$42,082	\$1.32
Farmers RECC	\$604,892	\$50,408	\$0.44
Fleming-Mason Energy Coop	\$104,500	\$17,417	\$0.57
Grayson RECC	\$118,754	\$19,792	\$1.20
Inter-County Energy Coop	\$219,099	\$36,516	\$1.21
Licking Valley RECC	\$93,387	\$15,564	\$0.69
Nolin RECC	\$497,051	\$82,842	\$1.91
Owen Electric Cooperative	\$1,754,800	\$146,233	\$2.19
Taylor County RECC	\$247,307	\$41,218	\$1.38

	<u>Total Amount of Under Recovery</u>	<u>Monthly Amount To Be Collected</u>	<u>Monthly Bill Impact</u>
Blue Grass Energy Cooperative	\$658,068	\$109,678	\$1.43
Cumberland Valley Electric	\$307,701	\$51,284	\$1.55
Jackson Energy Cooperative	\$151,422	\$25,237	\$0.41
Salt River Energy Cooperative	\$219,205	\$36,534	\$0.53
Shelby Energy Cooperative	\$34,990	\$5,832	\$0.22
South Kentucky RECC	\$1,109,224	\$184,871	\$2.00

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