

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 BILLING PERIODS ENDING	)	2015-00281
JUNE 30, 2014 AND DECEMBER 31, 2014,	)	
FOR THE TWO-YEAR BILLING PERIOD ENDING	)	
JUNE 30, 2015 AND THE PASS THROUGH	)	
MECHANISM FOR ITS SIXTEEN MEMBER	)	
DISTRIBUTION COOPERATIVES	)	

ORDER

On August 31, 2015, the Commission initiated a two-year review and two six-month reviews of East Kentucky Power Cooperative, Inc.'s ("EKPC") environmental surcharge<sup>1</sup> as billed to its member distribution cooperatives ("Member Cooperatives") for the two-year period July 1, 2013, to June 30, 2015, and for the six-month periods of . January 1, 2014, to June 30, 2014, and July 1, 2014, to December 31, 2014. 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. 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.

---

<sup>1</sup> 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 August 31, 2015 Order also initiated a two-year review of the 16 EKPC Member Cooperatives' pass-through mechanism<sup>2</sup> as billed to their retail member customers for the two-year period August 1, 2013, to July 31, 2015, and for the six-month periods February 1, 2014, to July 31, 2014, and August 1, 2014, to January 31, 2015.<sup>3</sup>

The Commission issued a procedural schedule that provided for two rounds of 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 two rounds of discovery. An informal conference was held March 2, 2016. There were no parties requesting intervenor status to this proceeding. On March 15, 2015, EKPC filed a motion stating that EKPC and the Member Cooperatives believed the case record is complete and further stated that this case may be submitted for decision on the current record without a hearing. That motion was withdrawn on March 24, 2015, pending submission of revised data responses, which were filed April 5, 2016.

---

<sup>2</sup> Case No. 2004-00372, *Application of Big Sandy RECC, Blue Grass Energy Cooperative Corporation, Clark Energy Cooperative, Cumberland Valley Electric, Inc., Farmers RECC, Fleming-Mason Energy Cooperative, Inc., Grayson RECC, Inter-County Energy Cooperative Corporation, Jackson Energy Cooperative Corporation, Licking Valley RECC, Nolin RECC, Owen Electric Cooperative, Inc., Salt River Electric Cooperative Corporation, Shelby Energy Cooperative, Inc., 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).

<sup>3</sup> The February 2, 2005 Settlement Agreement ("Settlement Agreement") approved in Case Nos. 2004-00321, *East Kentucky Power Cooperative, Inc.* (Ky. PSC Mar. 17, 2005). and 2004-00372, *Big Sandy RECC, et. al.* (Ky. PSC Mar. 17, 2005), 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 May 2015 are billed to the member distribution cooperatives in the months of July 2013 through June 2015, with these same costs passed through to the member customers on the bills for August 2013 through July 2015.

## SURCHARGE ADJUSTMENT

The August 31, 2015 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 a net under-recovery of \$391,155<sup>4</sup> for the period under review due to reporting errors in operating and maintenance (“O&M”) expenses. Because the errors impact the 12-month O&M average and working capital calculations, the errors carried over to the expense months of June 2015 through February 2016, which are outside of the review periods. For the months of June 2015 through February 2016 EKPC experienced an over-recovery of \$93,943.<sup>5</sup> EKPC proposes that it be permitted to recognize this post-review period adjustment as an offset to its review period net under-recovery, resulting in a net under-recovery of \$297,212.<sup>6</sup> EKPC proposes to include the net under-recovery as an adjustment to its environmental revenue requirement in the first two months following the Commission’s Order in this proceeding.

EKPC states that the corrections to the O&M expenses and the resulting effect to the nine monthly surcharge filings, all of which are beyond the review periods covered in this case, are already known. If the post-review period corrections were addressed only in subsequent environmental surcharge reviews, these corrections would affect the next two six-month reviews. The corrections likely would not be finalized until late 2016 or

---

<sup>4</sup> EKPC’s Revised Responses to Commission Staff’s First Request for Information (filed Apr. 5, 2016), Item 1 at 4.

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

<sup>6</sup> *Id. at 5.*

early 2017. EKPC believes it is reasonable and administratively efficient to address the post-review period corrections in the current review. EKPC cited a similar request by Kentucky Power in Case No. 2006-00128,<sup>7</sup> which the Commission approved.

The Commission is not persuaded by EKPC's argument. The Commission has a long-standing practice of not considering environmental surcharge operations that occur outside of the review period. As set forth and mandated by KRS 278.183(1), a utility may recover its current environmental compliance costs. 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. Historically, the Commission has limited alterations to a utility's environmental surcharge billings to those costs that occur within the time periods under review as provided for by KRS 278.183. Regarding the case cited by EKPC in support of its position, the Commission believes that the decision to approve Kentucky Power's post-review period adjustment was in error and not consistent with the plain language of the environmental surcharge statute or other Commission precedent. In a more recent case, the Commission reaffirmed its long-standing practice of not addressing costs that lie outside the review period.<sup>8</sup> Those costs should be addressed in the review proceeding that covers the time period in which the costs were billed.<sup>9</sup> Accordingly, the

---

<sup>7</sup> Case No. 2006-00128, *An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Power Company for the Six-Month Billing Periods Ending December 31, 2002, 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* (Ky. PSC June 21, 2007).

<sup>8</sup> 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).

<sup>9</sup> *Id.*

Commission finds that EKPC should not be allowed to include the over-recovery of \$93,943 in its surcharge adjustment.

The Commission has reviewed and finds reasonable EKPC's calculation of its net under-recovery of \$391,155 for the review period covered in this proceeding. The Commission also finds reasonable EKPC's proposal to include the under-recovery as an adjustment on Line 11 of ES Form 1.1 of the monthly environmental surcharge filing in the first two billing months following the date of this Order.

#### 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.<sup>10</sup>

EKPC updated the weighted average cost of debt as of May 31, 2015, the last expense month of the review period, as requested in the initial request for information in this case. EKPC determined the rate of return, utilizing a TIER factor of 1.50 which was authorized in Case No. 2011-00032.<sup>11</sup> Utilizing these components, EKPC calculated an updated rate of return as of May 31, 2013 of 6.045 percent. EKPC proposed an

---

<sup>10</sup> Case No. 2004-00321, *East Kentucky Power Cooperative, Inc.* (Ky. PSC Mar. 17, 2005), Order, Appendix A at 3.

<sup>11</sup> 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).

overall rate of return of 6.045 percent be used starting with the first month following the final Order in this case,<sup>12</sup>

The Commission has reviewed and finds reasonable EKPC's determination of the updated rate of return reflecting the updated weighted average cost of debt as of May 31, 2013 and a 1.50 TIER factor. The Commission finds that EKPC should use a rate of return of 6.045 percent for all environmental surcharge monthly filings submitted after the date of this Order.

### RETAIL PASS-THROUGH MECHANISM

#### Retail Pass-Through Adjustment

Each of the Member Cooperatives determined an over- or under-recovery for its surcharge pass-through mechanism, with ten of the Member Cooperatives having over-recoveries and six of the Member Cooperatives having under-recoveries. EKPC stated that the Member Cooperatives, with the exception of Owen Electric Cooperative, Inc. ("Owen Electric"), proposed that the over-recoveries be refunded to, or the under-recoveries be collected from, ratepayers as an adjustment to the retail pass-through factor for each month in the six-month period following the Commission's Order in this proceeding. Owen Electric has requested a 12-month amortization period.

The Commission has reviewed and finds reasonable each of the Member Cooperatives' calculations of their respective over-recoveries and under-recoveries for the review periods covered in this proceeding. The Commission finds reasonable the Member Cooperatives' proposals to amortize their respective accumulated over- or under-recovery amounts in each of the first six billing months following the final Order in

---

<sup>12</sup> EKPC's Response to the Commission Staff's First Request for Information, Item 5 at 8 of 12.

this proceeding, except Owen Electric, which will be allowed to amortize its over-recovery over 12 months.

A schedule of the over- or under-recovery for each Member Cooperative and the related monthly adjustments are 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.

#### Member Cooperatives Over- or Under-Recovery Calculation

In the review immediately preceding this case, Case No. 2014-00051,<sup>13</sup> the Member Cooperatives proposed a change to the calculation methodology for determining their respective over/under recovery amounts for the review periods, which the Commission denied in its Order.<sup>14</sup> The current calculation methodology has been in place since EKPC was authorized to institute a surcharge in 2005. The proposed change arose from the swings the Member Cooperatives experienced in the over/under recovery amounts determined for that review period due to amortization of over/under amounts in previous reviews, and the resulting impacts on the Member Cooperatives' determination of their respective over-/under-recovery amounts in the next review period. The Member Cooperatives maintain that they don't ever completely amortize the over- or under-recovery amounts under the current methodology, and they continue

---

<sup>13</sup> Case No. 2014-00051, *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, 2013 and the Pass Through Mechanism for Its Sixteen Member Distribution Cooperatives* (Ky. PSC Oct. 12, 2015).

<sup>14</sup> *Id.* The Commission denied the request to utilize the proposed methodology, but held that the Cooperatives could propose a new methodology in the next review case. The Commission based its decision, in part, upon the fact that the Cooperatives did not unanimously agree on the then proposed methodology.

to assert the need for a modification to the methodology used to determine their respective over/under-recovery amounts.

The Member Cooperatives have proposed a revised methodology for determining their respective over/under-recovery amounts. The goal of the revised methodology is to remove the effects of the previously authorized amortization of over/under-recovery amounts from the determination of the current review period's over/under-recovery. The proposed format recognizes previously authorized amortization amounts, as well as the amortization that has taken place during the review period. The Member Cooperatives believe that removing the effects of the amortization from the calculation results in a more proper matching of each Member Cooperative's environmental revenue and expense than under the current calculation methodology. They also believe that the difference in the amounts results in a truer calculation of the over- or under-recovery for the month.

The Member Cooperatives are proposing to continue the current calculation methodology for this review as this case completes a two-year review period. The Member Cooperatives believe it would be more appropriate to begin applying the revised methodology with the start of a new two-year review period, and they are proposing that the revised methodology be applied to surcharge review cases subsequent to this case.

The Commission has reviewed and finds reasonable the Member Cooperatives' proposed revision to their over-/under-calculation methodology as described in the Supplemental Testimony of Isaac S. Scott.<sup>15</sup> The Commission also finds reasonable

---

<sup>15</sup> EKPC's Motion Requesting Leave to File Supplemental Testimony, the Scheduling of an Informal Conference, and the Suspension of the Current Procedural Schedule (filed Jan. 28, 2016).

the Member Cooperatives' proposal that the revised calculation methodology be effective with the review subsequent to this case.

#### SURCHARGE ROLL-IN

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." EKPC proposes not to incorporate, or "roll in," any of its environmental surcharge amounts into its existing base rates in this proceeding. EKPC states that it believes a roll-in of environmental costs should be allocated between demand and energy rate components based on a cost-of-service study, and should occur during a wholesale base rate case proceeding. As with a roll-in to its wholesale base rates, EKPC believes that the corresponding adjustment to retail base rates should be performed in conjunction with a base-rate proceeding. Further, EKPC states that several of its Member Cooperatives believe it is important that retail customers be aware of the full cost of environmental compliance and the impact on their monthly bills.<sup>16</sup> EKPC states that performing a roll-in would not provide full disclosure of environmental compliance costs on retail customers' bills, as a significant portion of such costs would be collected in base rates.

The Commission has reviewed and finds reasonable EKPC's recommendation not to roll environmental surcharge amounts into base rates at the present time.

#### OTHER ISSUES

In Case No. 2014-00051, EKPC requested that the Commission issue its final Order in environmental surcharge review cases within the first ten days of the month or

---

<sup>16</sup> Direct Testimony of Isaac S. Scott at 17.

after the 21<sup>st</sup> day of the month. The Commission accommodated EKPC's request in that case. EKPC has reiterated the request in the instant proceeding. In all cases, the Commission endeavors to meet all reasonable requests by the utilities, and will continue to do so in the future.

IT IS THEREFORE ORDERED that:

1. The amounts billed by EKPC through its environmental surcharge for the period July 1, 2013, to June 30, 2015, are approved.

2. Beginning in the first full-billing month following the date of this Order, EKPC shall increase its jurisdictional environmental revenue requirement by \$195,578 for one month, and \$195,577 for one month.

3. EKPC's request to include the over-recovery for June 2015 through February 2016 in the adjustment in this review is denied.

4. EKPC shall use a rate of return of 6.045 percent in all monthly environmental surcharge filings subsequent to the date of this Order.

5. 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, as discussed herein, following the date of this order.

6. The Member Cooperatives shall use the proposed calculation methodology as discussed herein to calculate their monthly over/under amounts beginning with the next review proceeding to be opened following the closure of this matter.

By the Commission

ENTERED  
**APR 08 2016**  
KENTUCKY PUBLIC  
SERVICE COMMISSION

ATTEST:

*Raeon D. Beaswell*  
Acting Executive Director

Case No. 2015-00281

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2015-00281 DATED **APR 08 2016**

Member Cooperatives' Adjustment to  
Monthly Pass-Through Mechanism

After the date of this Order, the EKPC Member Cooperatives shall include the following monthly adjustments in the determination of the applicable pass-through factors in accordance with the approved amortization period for each Member Cooperative.

	<u>Total Amount of Over Recovery</u>	<u>Monthly Amount To Be Returned</u>	<u>Monthly Bill Impact</u>
Clark Energy Cooperative	\$206,883	\$34,481	\$1.21
Farmers RECC	\$520,602	\$86,767	\$2.38
Fleming-Mason Energy Cooperative	\$54,765	\$9,127	\$0.27
Grayson RECC	\$30,578	\$5,096	\$0.30
Inter-County Energy Cooperative Corp.	\$270,395	\$45,066	\$1.50
Jackson Energy Cooperative	\$50,955	\$8,493	\$0.12
Licking Valley RECC	\$5,705	\$951	\$0.04
Nolin RECC	\$148,835	\$24,806	\$0.51
Owen Electric Cooperative	\$1,362,485	\$113,540	\$1.59
Taylor County RECC	\$191,419	\$31,903	\$0.83

	<u>Total Amount of Under Recovery</u>	<u>Monthly Amount To Be Collected</u>	<u>Monthly Bill Impact</u>
Big Sandy RECC	\$5,648	\$941	\$0.05
Blue Grass Energy Cooperative	\$91,062	\$15,177	\$0.18
Cumberland Valley Electric	\$94,932	\$15,822	\$0.49
Salt River Energy Cooperative Corp.	\$121,648	\$20,275	\$0.31
Shelby Energy Cooperative	\$19,730	\$3,288	\$0.14
South Kentucky RECC	\$541,986	\$90,331	\$0.92

1/ Monthly amount is based on 12 months amortization.

\*Taylor County R.E.C.C.  
Taylor County R.E.C.C.  
625 West Main Street  
P. O. Box 100  
Campbellsville, KY 42719

\*Salt River Electric Cooperative Corp  
Salt River Electric Cooperative Corp.  
111 West Brashear Avenue  
P. O. Box 609  
Bardstown, KY 40004

\*Jackson Energy Cooperative Corporati  
Jackson Energy Cooperative Corporation  
115 Jackson Energy Lane  
McKee, KY 40447

\*David S Samford  
Goss Samford, PLLC  
2365 Harrodsburg Road, Suite B325  
Lexington, KENTUCKY 40504

\*Blue Grass Energy Cooperative Corp.  
Blue Grass Energy Cooperative Corp.  
1201 Lexington Road  
P. O. Box 990  
Nicholasville, KY 40340-0990

\*Licking Valley R.E.C.C.  
Licking Valley R.E.C.C.  
P. O. Box 605  
271 Main Street  
West Liberty, KY 41472

\*Big Sandy R.E.C.C.  
Big Sandy R.E.C.C.  
504 11th Street  
Paintsville, KY 41240-1422

\*Clark Energy Cooperative, Inc.  
Clark Energy Cooperative, Inc.  
2640 Ironworks Road  
P. O. Box 748  
Winchester, KY 40392-0748

\*Owen Electric Cooperative, Inc.  
Owen Electric Cooperative, Inc.  
8205 Highway 127 North  
P. O. Box 400  
Owenton, KY 40359

\*Farmers R.E.C.C.  
Farmers R.E.C.C.  
504 South Broadway  
P. O. Box 1298  
Glasgow, KY 42141-1298

\*Cumberland Valley Electric, Inc.  
Cumberland Valley Electric, Inc.  
Highway 25E  
P. O. Box 440  
Gray, KY 40734

\*Shelby Energy Cooperative, Inc.  
Shelby Energy Cooperative, Inc.  
620 Old Finchville Road  
Shelbyville, KY 40065

\*Fleming-Mason Energy Cooperative, In  
Fleming-Mason Energy Cooperative, Inc.  
1449 Elizaville Road  
P. O. Box 328  
Flemingsburg, KY 41041

\*East Kentucky Power Cooperative, Inc.  
4775 Lexington Road  
P. O. Box 707  
Winchester, KY 40392-0707

\*Grayson R.E.C.C.  
Grayson R.E.C.C.  
109 Bagby Park  
Grayson, KY 41143

\*Nolin R.E.C.C.  
Nolin R.E.C.C.  
411 Ring Road  
Elizabethtown, KY 42701-6767

\*East Kentucky Power Cooperative, Inc  
East Kentucky Power Cooperative, Inc.  
4775 Lexington Road  
P. O. Box 707  
Winchester, KY 40392-0707

\*South Kentucky R.E.C.C.  
South Kentucky R.E.C.C.  
925-929 N Main Street  
P. O. Box 910  
Somerset, KY 42502-0910

\*Inter-County Energy Cooperative Corp  
Inter-County Energy Cooperative Corporation  
1009 Hustonville Road  
P. O. Box 87  
Danville, KY 40423-0087