

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	)	
UTILITIES COMPANY FOR THE SIX-MONTH	)	CASE NO.
BILLING PERIODS ENDING JANUARY 31, 2001,	)	2003-00068
JULY 31, 2001, JANUARY 31, 2002, AND	)	
JANUARY 31, 2003 AND FOR THE TWO-YEAR	)	
BILLING PERIODS ENDING JULY 31, 2000 AND	)	
JULY 31, 2002	)	

O R D E R

On December 1, 2003, the Commission granted reconsideration of the finding in its October 17, 2003 Order that Kentucky Utilities Company ("KU") should use 3.03 percent as the value for the Base Period Environmental Surcharge Factor ("BESF") when calculating its environmental surcharge using the base-current methodology. The Commission issued a data request as part of its Order granting rehearing, and KU filed its responses thereto. Neither the Attorney General nor the Kentucky Industrial Utility Customers, Inc. have filed any comments or requested a hearing in this matter. Therefore, this case stands submitted for decision based on the existing record.

BACKGROUND

In the October 17, 2003 Order, the Commission approved KU's adoption of the base-current methodology for the calculation of its environmental surcharge. The base-current methodology uses the following formula when calculating the Monthly Billed Environmental Surcharge Factor ("MESF"):

$$\text{MESF} = \text{CESF} - \text{BESF}$$

CESF is the Current Period Environmental Surcharge Factor and reflects the environmental surcharge costs for the current expense month. The CESF is stated as a percentage and is calculated by dividing the monthly jurisdictional revenue requirement by a rolling monthly average of jurisdictional revenues. The BESF reflects the environmental surcharge cost activity for the 12 months ending with the last month in the 2-year surcharge review period. The BESF is also stated as a percentage, and is calculated by dividing the 12-month jurisdictional revenue requirement by the 12-month jurisdictional revenues. The 12-month jurisdictional revenue requirement reflects the environmental surcharge costs that have been incorporated into a utility's base rates.<sup>1</sup> As approved in the October 17, 2003 Order, the revenue requirement and jurisdictional revenues used to determine the BESF reflect the surcharge operations for the same period of time, the last 12 months of a 2-year surcharge review period.

Under the base-current methodology, a utility will collect its total eligible environmental surcharge revenue requirement through a combination of the monthly environmental surcharge factor applied to customers' bills plus the environmental surcharge amount incorporated into base rates. The MESF is the portion of the total eligible environmental surcharge revenue requirement billed to customers as the environmental surcharge. The BESF is the portion of the total eligible environmental surcharge revenue requirement that has been incorporated into base rates.

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<sup>1</sup> The incorporation of environmental surcharge costs into base rates is commonly referred to as a "roll-in."

In its direct testimony in this case, KU calculated a BESF of 3.03 percent based on the environmental surcharge costs for the 12 months ending May 31, 2002.<sup>2</sup> This BESF was approved by the Commission's October 17, 2003 Order for use in KU's subsequent monthly surcharge filings. In its motion for reconsideration, KU contended that since the roll-in was taking effect with its November 2003 billing cycle, the BESF should be calculated using jurisdictional revenues for the 12 months ending September 30, 2003, the most recent period for which billing data was available. KU claimed that if the May 2002 jurisdictional revenues were used to determine the BESF, there would be a significant under-collection of revenue through the monthly surcharge. KU stated that using the September 30, 2003 level of revenues, the BESF would be 2.57 percent.<sup>3</sup>

KU stated that as it was implementing the decisions in the October 17, 2003 Order, it discovered that its 12-month jurisdictional revenues as of May 31, 2002 were significantly lower than the 12-month jurisdictional revenues as of September 30, 2003. KU claimed its jurisdictional revenues for the 12 months ending September 30, 2003 were \$686,909,793. KU argued that due to the significant difference in the level of jurisdictional revenues, the use of a BESF of 3.03 percent implied that KU had rolled \$21,175,727 into base rates, rather than \$17,943,154.<sup>4</sup> KU contended that this overstated the BESF, and resulted in the MESF billed to customers each month being

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<sup>2</sup> KU's jurisdictional environmental revenue requirement for the 12 months ending May 31, 2002 was \$17,943,154, while its jurisdictional revenues for the same period were \$592,553,398. Dividing the revenue requirement by the revenues equals 3.03 percent.

<sup>3</sup> KU's Motion for Reconsideration at 3.

<sup>4</sup> Response to the Request for Information, December 1, 2003 Order, Appendix A, Item 4.

understated, and that the difference between the actual amount rolled into base rates and the level implied by the 3.03 percent BESF was not being recovered from customers.

In its December 1, 2003 Order, the Commission granted the motion for reconsideration and noted it could not determine whether KU was contending there was an error in the October 17, 2003 Order or whether KU was wanting to revise its testimony and exhibits to support a calculation that differed from the one previously filed in this case. The Commission also indicated that it was unable to verify the accuracy of the proposed revised BESF of 2.57 percent. In its subsequent data responses, KU stated that it did not determine that the use of a BESF of 3.03 percent would result in an under-collection of environmental surcharge revenues until after the receipt of the October 17, 2003 Order. KU also submitted an analysis of revenues reflecting the use of a BESF set at 2.57 percent.<sup>5</sup>

## ANALYSIS

### BESF Formula

In the base-current approach formula  $MESF = CESF - BESF$ , the BESF represents the portion of the environmental surcharge that is incorporated into KU's existing base rates. If the BESF is too high, the calculated MESF will be too low, resulting in an under-recovery of environmental surcharge costs. Conversely, if the

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<sup>5</sup> KU's revenue analysis reflected the effects of the roll-in, where a reduction in surcharge revenues is offset with a corresponding increase in base rate revenues. The analysis showed that if a BESF of 3.03 percent were utilized, the reduction in surcharge revenues would be \$3,188,912 greater than the surcharge amount rolled into base rates. When the BESF of 2.57 percent was used, the reduction in surcharge revenues would be \$43,004 lower than the surcharge amount rolled into base rates. See Response to the Request for Information, December 1, 2003 Order, Appendix A, Item 4.

BESF is too low, the MESF will be too high, resulting in an over-recovery of environmental surcharge costs.

In its motion for reconsideration, KU has raised the issue of the appropriate 12-month period of jurisdictional revenues to use in the BESF calculation. As part of the rehearing process, the Commission has reviewed the original concept for the BESF as part of the base-current approach. The Commission has concluded that the 12-month jurisdictional environmental revenue requirement used in the BESF calculation should continue to reflect the environmental surcharge costs rolled into base rates, and the amount rolled-in should be based on the last 12 months of the appropriate 2-year surcharge review period.<sup>6</sup>

The Commission has also concluded that requiring the 12-month jurisdictional revenues to reflect the same time period as the jurisdictional revenue requirement is inappropriate and should be changed. The jurisdictional revenues used in the BESF calculation should reflect the revenues for the most recent 12-month period prior to the roll-in. Using this level of revenues is the most accurate means of reflecting the portion of environmental surcharge costs that have been rolled into existing base rates.<sup>7</sup> As noted previously, the BESF represents the portion of the environmental surcharge incorporated into existing base rates.

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<sup>6</sup> In the current proceeding, the 12-month jurisdictional revenue requirement should reflect the 12 months ending May 31, 2002.

<sup>7</sup> In the current proceeding, the 12-month jurisdictional revenues should reflect the 12 months ending September 30, 2003.

## Calculation of BESF

As stated previously in this Order, the BESF is calculated by dividing the 12-month jurisdictional environmental revenue requirement by the 12-month jurisdictional revenues. While KU has not disputed or challenged this formula, it has not provided the calculations using this formula that support its revised BESF of 2.57 percent. KU supported the 2.57 percent value by arguing that applying 2.57 percent to actual surcharge billing factors and its revised revenues yielded the correct reduction in the surcharge revenues collected.<sup>8</sup> In discussing the calculations it did provide, KU indicated that it annualized the impact of a recent Fuel Adjustment Clause (“FAC”) roll-in and the increase in its Earnings Sharing Mechanism billing factor.<sup>9</sup>

The BESF calculation, like all other components in the environmental surcharge, is to be calculated using actual amounts. Annualizing the effects of revenue changes is normally recognized in base rate cases and may be necessary to recognize when calculating new base rates in conjunction with a roll-in. However, it is not appropriate to annualize revenues when calculating components of the environmental surcharge, which have always reflected actual amounts.

The jurisdictional revenues used in the BESF calculation are composed of base revenues and FAC revenues. The Commission has determined that KU's jurisdictional

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<sup>8</sup> Response to the Request for Information, December 1, 2003 Order, Appendix A, Item 3, page 2 of 3.

<sup>9</sup> Id.

revenues for the 12 months ending September 30, 2003 were \$669,608,033.<sup>10</sup> Using the roll-in amount of \$17,943,154 and the actual jurisdictional revenues for the 12 months ending September 30, 2003, the Commission has calculated the BESF to be 2.68 percent. This BESF should be used in all monthly surcharge filings submitted after the date of this Order.

The Commission is concerned that KU apparently did not become aware of this situation until it was finalizing the tariff changes after the receipt of the October 17, 2003 Order. KU's argument to revise the BESF was based on its discovery of significant changes in its jurisdictional revenues. While KU was aware of changes in its revenues due to a roll-in of its FAC as early as June 2003,<sup>11</sup> it did not alert the Commission to a possible problem with the BESF calculation until November 10, 2003 when it filed its motion for reconsideration. The Commission reminds KU that it has the responsibility to bring these situations to the Commission's attention promptly.

IT IS THEREFORE ORDERED that:

1. The formula for calculating the BESF component of KU's environmental surcharge under the base-current approach shall be modified to the extent that the jurisdictional revenues shall be the 12-month jurisdictional revenues as of September 30, 2003, which is the most recent 12-month period prior to the surcharge roll-in.

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<sup>10</sup> See KU's Monthly Environmental Surcharge Factor filing dated October 21, 2003, ES Form 3.00, Expense Month of September 2003. The sum of the amounts shown in column (6) of ES Form 3.00 for the months of October 2002 through and including September 2003 total \$669,608,033.

<sup>11</sup> Response to the Commission Staff's Second Data Request dated May 23, 2003, Item 6. In response to a question concerning how KU would roll-in the surcharge into its base rates, KU noted the potential change in its revenues due to the FAC roll-in that had been authorized.

2. The BESF for KU's environmental surcharge calculations submitted after the date of this Order is 2.68 percent.

3. All other provisions of the Commission's October 17, 2003 Order shall remain in effect.

Done at Frankfort, Kentucky, this 4<sup>th</sup> day of May, 2004.

By the Commission

ATTEST:

  
Executive Director