COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION BY THE PUBLIC SERVICE	)	
COMMISSION OF THE ENVIRONMENTAL	)	CASE NO.
SURCHARGE MECHANISM OF KENTUCKY	)	2011-00231
UTILITIES COMPANY FOR THE TWO-YEAR	)	
BILLING PERIOD ENDING APRIL 30, 2011	)	

O R D E R

On August 9, 2011, the Commission initiated a two-year review of Kentucky Utilities Company's ("KU") environmental surcharge as billed to customers for the two-year period from May 1, 2009 to April 30, 2011.[1] 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 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.

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[1] KU's surcharge is billed on a two-month lag. Thus surcharge billings for May 2009 through April 2011 are based on costs incurred from March 2009 through February 2011.

The Commission issued a procedural schedule on August 9, 2011 that provided for discovery, the filing of prepared testimony, an informal conference, and a public hearing. KU filed prepared direct testimony and responded to requests for information. On September 28, 2011, KU and Commission Staff ("Staff") participated in an informal conference to discuss the issues in the case. During the conference, Staff requested further information, which KU submitted on October 7, 2011. On November 10, 2011, KU requested that the Commission delay issuing an order in this proceeding until the issuance of a final Order in Case No. 2011-00161,[2] concerning the Settlement Agreement, Stipulation, and Recommendation ("Settlement Agreement") submitted in that case. KU indicated it would file supplemental information in this case the week of January 2, 2012 concerning the allocation methodology to be used for its roll-in to base rates of environmental costs.[3] Kentucky Industrial Utility Customers, Inc. petitioned to intervene at this point, which petition was granted on November 18, 2011. KU requested that this case be submitted for a decision based on the existing record without a public hearing. Finding good cause, the Commission will grant KU's request and decide this case based on the evidence of record without a hearing.

SURCHARGE ADJUSTMENT

The August 9, 2011 Order initiating this case indicated that since the period under review in this proceeding may have resulted in over- or under-recoveries, the

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[2] Case No. 2011-00161, Application of Kentucky Utilities Company for Certificates of Public Convenience and Necessity and Approval of its 2011 Compliance Plan for Recovery by Environmental Surcharge (Ky. PSC Dec. 15, 2011).

[3] The allocation methodology was one of the issues addressed in the Settlement Agreement submitted in Case No. 2011-00161.

Commission would entertain proposals to adopt one adjustment factor to net all over- or under-recoveries. KU determined that it had a net over-recovery of its environmental costs for the period of $3,580,868.[4] KU proposed that the net over-recovery be refunded to customers over a six-month period by decreasing the total jurisdictional environmental surcharge revenue requirement by $596,811 per month for the first four months and $596,812 for the last two months beginning in the second full billing month following the Commission's decision in this proceeding.[5]

The Commission has reviewed and finds reasonable KU's calculation of a net over-recovery of $3,580,868 for the billing period covered in this proceeding. The Commission also finds reasonable KU's proposal to decrease the total jurisdictional environmental surcharge revenue requirement in each of the first four billing months by $596,811 per month and by $596,812 per month for the next two months, beginning in the second full billing month following the Commission's decision in this proceeding. KU calculates that a customer using 1,000 kWh would see a decrease of approximately $0.38 per month associated with the refund of the net over-recovery during the six-month period.

SURCHARGE ROLL-IN

KU proposed that it was appropriate in this case to incorporate surcharge amounts found just and reasonable for the two-year billing period into its existing base rates. KU recommended that this "roll-in" be in the amount of $49,410,832.[6] KU

[4] Conroy Revised Direct Testimony at 4.

[5] Id. at 6.

[6] Id. at 7.

determined the roll-in amount using the base-current methodology, consistent with current practice and as previously approved by the Commission. The Commission has reviewed and finds it reasonable that $49,410,832 from the surcharge should be rolled into KU's existing base rates.

ALLOCATION OF ROLL-IN

KU proposed to follow the methodology approved by the Commission in the Settlement Agreement in Case No. 2011-00161, for the base rate roll-in. Per the Settlement Agreement, KU's rate classes will be divided into two groups: Group 1, as identified in Section 5.03 of the Settlement Agreement;[7] and Group 2, as identified in Section 5.04 of the Settlement Agreement.[8] The $49,410,832 total roll-in was allocated between the two groups based on the percentage of each group's total revenue, excluding base environmental surcharge revenue, to KU's total revenue, excluding base environmental surcharge revenue. The rolled-in amounts for Group 1 also use total billed revenues excluding base environmental surcharge revenues to allocate costs to base rates between the rate classes in Group 1. For Group 2 rate classes, the roll-in will be allocated based on non-fuel revenues only for each Group 2 rate class, rather than total revenues excluding base environmental surcharge revenues, which has been the allocation methodology previously utilized for all rate classes, including

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[7] For KU, Group 1 would include the following rate classes: Residential Service, Volunteer Fire Department Service, All Electric School, Street Lighting Service, Private Outdoor Lighting, Lighting Energy Service, Traffic Energy Service, Dark Sky Friendly, and Low Emission Vehicle Service.

[8] For KU, Group 2 would include the following rate classes: General Service, Power Service, Time-of-Day Secondary Service, Time-of-Day Primary Service, Retail Transmission Service, Fluctuating Load Service, and special contracts.

what are now Group 2 rate classes. The Commission has reviewed and finds reasonable KU's proposal to allocate the roll-in of $49,410,832 pursuant to the terms of the Settlement Agreement in Case No. 2011-00161. In accordance with the terms of the Settlement Agreement, KU shall use the revenue allocation methodology as described above unless changed by future Commission orders. The impact of the change in revenue allocation shall be addressed by KU in its next two two-year environmental surcharge reviews or compliance plan proceedings, and if appropriate, KU will offer recommendations after consulting with the intervenors that are parties to the Settlement Agreement.

RATE OF RETURN

KU provided the outstanding balances for its long-term debt, short-term debt, and common equity as of February 28, 2011, the last expense month of the review period. It also provided the blended interest rates for the long-term debt and short-term debt as of February 28, 2011.[9] Using this information, along with the currently approved 10.63 percent return on equity,[10] KU calculated an overall rate of return on capital, before

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[9] KU's Response to Commission Staff's First Request for Information, Appendix B, Item 6.

[10] Case No. 2009-00548, Application of Kentucky Utilities Company for an Adjustment of Base Rates (Ky. PSC Jul. 30, 2010).

income tax gross-up, of 7.43 percent.[11] KU also provided the overall rate of return on capital reflecting the tax gross-up approach approved in Case No. 2004-00426.[12]

The Commission has reviewed KU's determination of the overall rate of return on capital and finds the 7.43 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. 2004-00426. Therefore, the Commission finds that the weighted average cost of capital of 7.43 percent and the income tax gross-up factor of 0.56, which produces an overall grossed-up return of 10.56 percent, should be used in all KU monthly environmental surcharge filings subsequent to the date of this Order for the 2005, 2006, and 2009 Compliance Plans. Pursuant to the Settlement Agreement approved in Case 2011-00161, KU shall use a return-on-equity rate of 10.1 percent for projects in its 2011 Compliance Plan to calculate an overall grossed-up rate of return to be used in all KU monthly environmental surcharge filings subsequent to the date of this Order.

IT IS THEREFORE ORDERED that:

1. KU's request to submit this case for a decision on the existing evidence of record without a hearing is granted.

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[11] KU's Response to Commission Staff's First Request for Information, Appendix B, Item 6.

[12] Case No. 2004-00426, The Application of Kentucky Utilities Company for a Certificate of Public Convenience and Necessity to Construct Flue Gas Desulfurization Systems and Approval of Its 2004 Compliance Plan for Recovery by Environmental Surcharge, Final Order (Ky. PSC Jun. 20, 2005), and Response to the Commission Staff's First Information Request, Item 6 (Ky. PSC Aug. 9, 2011). In the response, KU determined that the income tax gross-up factor was 0.56 which would produce a tax grossed-up weighted average cost of capital of 10.56 percent.

2. KU shall include a $596,811 monthly decrease in its jurisdictional environmental revenue requirement determined in the first four months and a $596,812 decrease in the next two months, beginning in the second full billing month following the month in which the Commission issues its Final Order in this proceeding.

3. KU shall roll $49,410,832 into its existing base rates in environmental surcharge amounts found to be just and reasonable herein. The roll-in shall be allocated to the customer classes as described in the Settlement Agreement approved in Case No. 2011-00161.

4. For the 2005, 2006, and 2009 Compliance Plans, KU shall use an overall rate of return on capital of 7.43 percent, a tax gross-up factor of 0.56, a return-on-equity rate of 10.63 percent and an overall grossed-up return of 10.56 percent in all monthly environmental surcharge filings subsequent to the date of this Order.

5. For the 2011 Compliance Plan, KU shall calculate an overall rate of return on capital using a return-on-equity rate of 10.1 percent for all projects included in the 2011 Compliance Plan in all monthly environmental surcharge filings subsequent to the date of this Order.

6. KU shall make the proposed modifications described herein to the calculation of the monthly environmental surcharge billing factor beginning with the second full billing month following the month in which the Commission issues its final Order in this proceeding.

7. Within 20 days of the date of this Order, KU shall file: revised tariffs reflecting the changes to its base rates as a result of the roll-in of environmental

surcharge amounts described herein; the same type of supporting documentation it filed in Case No. 2007-00379; and a red-lined version of its tariffs.

8. KU shall file revised environmental surcharge tariffs reflecting the changes described herein within 20 days of the date of this Order.

By the Commission

ENTERED
JAN 31 2012
KENTUCKY PUBLIC SERVICE COMMISSION

ATTEST:

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