

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)	2013-00242
UTILITIES COMPANY FOR THE TWO-YEAR)	
BILLING PERIOD ENDING APRIL 30, 2013)	

ORDER

On July 12, 2013, 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, 2011 to April 30, 2013.¹ 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. For purposes of this review, the Commission has examined KU's monthly environmental surcharges for the six-month billing period ending April 30, 2013, which is the last six-month billing period of the two-year billing period also ending April 30, 2013, and for the two-year billing period ending April 30, 2013. The three previous six-month

¹ KU's surcharge is billed on a two-month lag. Thus surcharge billings for May 2011 through April 2013 are based on costs incurred from March 2011 through February 2013.

billing periods of this two-year period were reviewed in Case Nos. 2012-00207 and 2012-00546.²

Coincident with the July 12, 2013 initiating Order, a procedural schedule was established providing for discovery, the filing of prepared testimony, and an informal conference. KU filed prepared direct testimony and responded to a request for information. On August 30, 2013, 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 September 6, 2013. Kentucky Industrial Utility Customers, Inc. ("KIUC") petitioned for full intervenor status on August 7, 2013, which petition was granted on August 16, 2013. KIUC did not issue any requests for information to KU or file testimony in this proceeding. KU requested that this case be submitted for a decision based on the existing record without a public hearing and no objections have been filed to that request. 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 July 12, 2013 Order initiating this case indicated that, since over- or under-recoveries of allowable environmental compliance costs may have occurred during the period under review, the Commission would entertain proposals to adopt one adjustment factor to net all over- or under-recoveries. KU determined that it had a net

² Case No. 2012-00207, An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Utilities Company for the Six-Month Billing Periods Ending October 31, 2011 and April 30, 2012, (Ky. PSC Sep. 26, 2012), and Case No. 2012-00546, An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Utilities Company for the Six-Month Billing Period Ending October 31, 2012 (Ky. PSC Apr. 19, 2013).

over-recovery of environmental costs for the six-month billing period ending April 30, 2013 of \$444,933.³ KU recommended that the Commission approve a decrease to the jurisdictional environmental surcharge revenue requirement of \$444,933 for one month, beginning in the second full billing month following the Commission's Final Order in this proceeding.⁴ The one-month decrease in jurisdictional environmental surcharge revenue requirement would be achieved by decreasing KU's environmental cost recovery billing factor for that same month.

The Commission has reviewed and finds reasonable KU's calculation of a net over-recovery of \$444,933 for the six-month billing period covered in this proceeding. The Commission also finds reasonable KU's proposal to refund this over-recovery by decreasing the total jurisdictional environmental surcharge revenue requirement by \$444,933 for one month beginning in the second full billing month following the date of this Order. KU stated that the actual average residential customer's usage for the 12 months ending May 31, 2013, is 1,178 kWh per month.⁵ KU calculates that for a residential customer using 1,178 kWh per month, the impact of its proposed decrease in environmental cost recovery billing factor would be a decrease of approximately \$0.43 for one month, using rates and adjustment clause factors in effect for the July 2013 billing month.⁶

³ Direct Testimony of Robert M. Conroy, p.11.

⁴ *Id.* at 12.

⁵ KU's response to Commission Staff's First Request for Information ("Staff's First Request"), Item 7.

⁶ *Id.*

SURCHARGE ROLL-IN

KU proposed that it was appropriate in this case to incorporate environmental surcharge amounts found just and reasonable for the two-year billing period into its existing base rates. KU recommended that this incremental “roll-in” be in the amount of \$45,820,651.⁷ KU determined the roll-in amount using the base-current methodology, consistent with current practice and as previously approved by the Commission. The incremental roll-in amount of \$45,820,651 was determined using the environmental surcharge rate base as of February 28, 2013, and environmental surcharge operating expenses for the 12-month period ending February 28, 2013. With the incremental roll-in of \$45,820,651, the total amount of environmental surcharge revenues that will be included in base rates will be \$50,966,954. The Commission has reviewed and finds it reasonable that \$45,820,651 from the surcharge should be rolled into KU’s existing base rates incrementally, resulting in total environmental surcharge revenues in base rates of \$50,966,954.

ALLOCATION OF ROLL-IN

KU proposed to follow the methodology used in the previous two-year review and approved by the Commission in Case No. 2011-00231⁸ for the base rate roll-in. That Order authorized the use of the methodology previously approved in the Settlement Agreement in Case No. 2011-00161.⁹ Per the Settlement Agreement, KU’s rate classes

⁷ Direct Testimony of Robert M. Conroy, p.13.

⁸ Case No. 2011-00231, An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Utilities Company for the Two-Year Billing Period Ending April 30, 2011 (Ky. PSC Feb. 29, 2012).

⁹ 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).

will be divided into two groups: Group 1, as identified in Section 5.03 of the Settlement Agreement;¹⁰ and Group 2, as identified in Section 5.04 of the Settlement Agreement.¹¹ The \$50,966,954 total roll-in is 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 what are now Group 2 rate classes. The Commission has reviewed and finds reasonable KU's proposal to allocate the roll-in of \$50,966,954 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 Settlement Agreement also requires KU to address the impact of the change in revenue allocation in its next two two-year environmental surcharge reviews or compliance plan proceedings, and if appropriate, to offer recommendations after consulting with specific intervenors that are parties to the

¹⁰ 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.

¹¹ 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.

Settlement Agreement. KU recommended that no changes be made to the allocation methodology because the results of the change are consistent with KU's expectations and there have been no concerns expressed by customers.

RATE OF RETURN

KU provided the outstanding balances for its long-term debt, short-term debt, and common equity as of February 28, 2013, 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, 2013.¹² Using this information, along with the currently approved 10.25 percent return on equity,¹³ KU calculated an overall rate of return on capital, before income tax gross-up, of 7.07 percent.¹⁴ KU also provided the overall rate of return on capital reflecting the tax gross-up approach approved in Case No. 2004-00426.¹⁵

The Commission has reviewed KU's determination of the overall rate of return on capital and finds the 7.07 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 7.07 percent and the income tax gross-up factor of 0.64, which produce an overall grossed-up return of 10.10 percent, should be used

¹² KU's Response to Staff's First Request, Item 6.

¹³ Case No. 2012-00221, Application of Kentucky Utilities Company for an Adjustment of its Electric Rates (Ky. PSC Jun. 14, 2013).

¹⁴ KU's Response to Staff's First Request, Item 6.

¹⁵ 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 Staff's First Request, Item 6. In the response, KU determined that the income tax gross-up factor was 0.64 which would produce a tax grossed-up weighted average cost of capital of 10.10 percent.

in all KU monthly environmental surcharge filings subsequent to the date of this Order for the 2009 and 2011 Compliance Plans.

OTHER ITEMS

KU proposed that its Environmental Cost Recovery Surcharge tariff ECR be updated to remove references to the Pre-2011 Plans from the Definitions, since it is no longer necessary to identify whether environmental costs are associated with the Pre-2011 plans or the 2011 compliance plan. The proposed effective date of the revised tariff would be the month in which the Final Order is issued in this case. The Commission has reviewed and finds reasonable KU's recommendation to update its Environmental Cost Recovery Surcharge tariff ECR as described herein.

KU also proposed changes to several of its environmental surcharge monthly reporting forms and the elimination of one form. The proposed changes are necessary to reflect utilization of a single rate of return on equity for all compliance plans as approved in Case No. 2012-00221, the elimination of the 2005 and 2006 amendments to the compliance plans from the environmental surcharge and removal of references to the Green River and Tyrone units, which have no approved projects and for which retirement dates have been announced. The Commission has reviewed and finds reasonable KU's recommendation to update the monthly environmental surcharge reports for the changes as stated herein.

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.

2. The environmental surcharge amounts determined by KU for the review period ending April 30, 2013 are just and reasonable.

3. In the second full billing month following the month in which the Commission issues its Final Order in this proceeding, KU shall decrease its jurisdictional environmental revenue requirement by \$444,933 for one month.

4. KU shall roll \$45,821,651 of incremental environmental surcharge amounts found to be just and reasonable herein into its existing base rates, for a total base rate environmental component of \$50,966,954. The roll-in shall be allocated to the customer classes as described in the Settlement Agreement approved in Case No. 2011-00161 and in Case No. 2011-00231.

5. KU shall use an overall rate of return on capital of 7.07 percent, a tax gross-up factor of 0.64, a return-on-equity rate of 10.25 percent and an overall grossed-up return of 10.10 percent in all monthly environmental surcharge filings subsequent to the date of this Order.

6. Within 20 days of the date of this Order, KU shall file with the Commission, using the Commission's electronic Tariff Filing System: 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. 2011-00231; other proposed language changes described herein; and a red-lined version of its tariffs.

7. KU's proposed changes to its monthly environmental surcharge reporting forms as described herein are approved and effective with the expense month in which the Order is issued in this proceeding.

By the Commission

ENTERED
NOV 14 2013
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:



Executive Director

Case No. 2013-00242

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