COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN ELECTRONIC EXAMINATION BY THE PUBLIC SERVICE COMMISSION OF THE ENVIRONMENTAL SURCHARGE MECHANISM OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR THE TWO-YEAR BILLING PERIOD ENDING APRIL 30, 2017	)))))	CASE NO. 2017-00267

ORDER

On July 27, 2017, the Commission initiated a two-year review of Louisville Gas and Electric Company's ("LG&E") environmental surcharge as billed to customers for the two-year period May 1, 2015, through April 30, 2017.[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 LG&E's monthly environmental surcharges for the six-month billing period ended April 30, 2017, which is the last six-month billing period of the two-year billing period ended April 30, 2017, and for the two-year billing period ended April 30, 2017. The three previous six-month billing

[1] LG&E's surcharge is billed on a two-month lag. Thus, surcharge billings for May 2015 through April 2017 are based on costs incurred from March 2015 through February 2017.

periods of this two-year period were reviewed in Case Nos. 2015-00412, 2016-00215, and 2016-00438.[2]

The Commission issued a procedural schedule on July 27, 2017, that provided for discovery and the filing of prepared testimony. LG&E filed prepared direct testimony and responded to three requests for information. There are no intervenors in this proceeding. On November 30, 2017, LG&E 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 LG&E's request and decide this case based on the evidence of record without a hearing.

SURCHARGE ADJUSTMENT

The July 27, 2017 Order initiating this case indicated that since the period under review in this proceeding may have resulted in over- or under-recoveries, the Commission would entertain proposals to adopt one adjustment factor to net all over- or under-recoveries. LG&E determined that it had a cumulative under-recovery of its environmental costs for the period of $3,995,561.[3] LG&E recommended that the Commission approve an increase to the jurisdictional environmental surcharge revenue requirement of $799,112 for four months and $799,113 for one month, beginning in the second full billing month following the Commission's Final Order in this proceeding.[4]

---

[2] Case No. 2015-00412, *An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Louisville Gas & Electric Company for the Six-Month Billing Period Ending October 31, 2015* (Ky. PSC Mar. 16, 2016); Case No. 2016-00215, *Electronic Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Louisville Gas & Electric Company for the Six-Month Billing Period Ending April 30, 2016* (Ky. PSC Oct. 24, 2016); and Case No. 2016-00438, *Electronic Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Louisville Gas & Electric Company for the Six-Month Billing Period October 31, 2016* (Ky. PSC July 23, 2016).

[3] Direct Testimony of Derek A. Rahn ("Rahn Testimony") at 6.

[4] *Id.* at 7–8.

The increase in jurisdictional environmental surcharge revenue requirement would increase LG&E's environmental cost recovery billing factor by approximately 0.93 percent per month for five months.[5] LG&E stated that the actual average residential customer's usage for the 12-month period ended June 30, 2017, is 959 kilowatt-hours ("kWh") per month.[6] LG&E calculates that for a residential customer using 959 kWh per month, the effect of its proposed increase in environmental cost recovery billing factor would be an increase of approximately $0.94 each month for five months, using rates and adjustment clause factors in effect for the June 2017 billing month.[7] The Commission has reviewed and finds reasonable LG&E's calculation of a net under-recovery of $3,995,561 for the billing period covered in this proceeding. The Commission also finds reasonable LG&E's proposal to increase the total jurisdictional environmental surcharge revenue requirement for four months by $799,112 and for one month by $799,113 beginning in the second full billing month following the date of this Order.

SURCHARGE ROLL-IN

LG&E 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. LG&E recommended an incremental "roll-in" be $52,893,140.[8] LG&E 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

[5] *Id.*

[6] Response to Commission Staff's First Request for Information ("Staff's First Request"), Item 6.

[7] *Id.*

[8] Rahn Testimony at 8.

of $52,893,140 was determined using the environmental surcharge rate base as of February 28, 2017, and environmental surcharge operating expenses for the 12-month period ended February 28, 2017. With the incremental roll-in of $52,893,140, the total amount of environmental surcharge revenues to be included in base rates is $126,556,149. The Commission has reviewed and finds it reasonable that $52,893,140 from the surcharge should be rolled into LG&E's existing base rates incrementally, resulting in total environmental surcharge revenues in base rates of $126,556,149.

ALLOCATION OF ROLL-IN

LG&E proposed to follow an allocation methodology originally approved in the Settlement Agreement in Case No. 2011-00162,[9] whereby LG&E's rate classes are divided into two groups: Group 1[10] and Group 2.[11] This methodology was first authorized for the base rate roll-in in review case 2011-00232,[12] as well as LG&E's most recent two-year review. In LG&E's most recent base rate case, Case No. 2016-00371,[13] LG&E updated its Environmental Cost Recovery Surcharge tariff to reflect the

[9] Case No. 2011-00162, *Application of Louisville Gas and Electric 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).

[10] Group 1 includes the following rate classes: Residential Service, Residential Time-of-Day Energy Service, Residential Tim-of-Day Demand Service, Volunteer Fire Department Service, Lighting Service, Restricted Lighting Service, Lighting Energy Service, and Traffic Energy Service.

[11] Group 2 includes the following rate classes: General Service, Power Service, Time-of-Day Secondary Service, Time-of-Day Primary Service, Retail Transmission Service, Fluctuating Load Service, Electric Vehicle Supply Equipment, Electric Vehicle Charging Service, School Power Service, School Time-of-Day Service, Outdoor Sports Lighting Service, and special contracts.

[12] Case No. 2011-00232, *An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Louisville Gas & Electric Company for the Two-Year Billing Period Ending April 30, 2011* (Ky. PSC Feb. 29, 2012).

[13] Case No. 2016-00371, *Application of Louisville Gas and Electric Company for an Adjustment of its Electric and Gas Rates and for Certificates of Public Convenience and Necessity*, Joint Errata Filing, Stipulation Exhibit 8: LG&E Tariffs – Errata Pages at 7 (filed Apr. 26, 2016).

current rate classes in each group. The $52,893,140 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 LG&E'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. LG&E recommended that no changes be made to the allocation methodology. The Commission has reviewed and found reasonable LG&E's proposal to allocate the roll-in of $52,893,140 pursuant to the terms of the Settlement Agreement in Case No. 2011-00162. In accordance with the terms of the Settlement Agreement, LG&E shall use the revenue allocation methodology as described above unless directed to do otherwise by the Commission.

RATE OF RETURN

LG&E provided the outstanding balances for its long-term debt, short-term debt, and common equity and the blended interest rates for the long-term debt and short-term debt as of February 28, 2017, the last expense month of the review period.[14] Using this information, along with the currently approved 9.70 percent return on equity ("ROE"),[15] LG&E calculated a weighted average cost of capital ("WACC") before income tax gross-up, of 7.04 percent for its 2009, 2011, and 2016 Environmental Compliance Plans

---

[14] Response to Staff's First Request, Item 7.

[15] Case No. 2016-00371, *Louisville Gas and Electric Company* (Ky. PSC Aug. 8, 2017).

("Compliance Plans").[16] LG&E also provided the overall WACC of 10.34 percent reflecting the tax gross-up approach approved in Case No. 2004-00421.[17]

The Commission has reviewed LG&E's calculation of the tax gross-up factor and finds that it is consistent with the approach approved in Case No. 2004-00421. The gross-up factor excludes the Internal Revenue Code §199 manufacturing tax deduction ("§199 deduction"), as LG&E expects to have taxable income for 2016 that will be offset by a net operating loss carry-forward.[18] The §199 deduction is not available to companies that do not have taxable income. Therefore, the Commission finds that the WACC for LG&E's Compliance Plans of 7.04 percent and the income tax gross-up factor of 0.61334, which produces an overall grossed-up return of 10.34 percent, should be used in all LG&E monthly environmental surcharge filings beginning in the second full-billing month following the date of this Order.

MONTHLY ES FORMS

Presently, LG&E separately reports the 2009 and 2011 Compliance Plans ("Pre-2016 Compliance Plans") and the 2016 Compliance Plan because the Commission approved a separate ROE for the 2016 Compliance Plan in Case No. 2016-00027. LG&E is proposing changes to its monthly environmental surcharge report forms ES Form 1.10, ES Form 2.00, and ES Form 2.40 to combine reporting for the Pre-2016 Compliance Plans and the 2016 Compliance Plan. LG&E states that the Final Order in Case No. 2016-00438 reduced the ROE for all Compliance Plans to 9.70 percent and

---

[16] Response to Staff's First Request, Item 7.

[17] Case No. 2004-00421, *The Application of Louisville Gas and Electric Company for Approval of its 2004 Compliance Plan for Recovery by Environmental Surcharge* (Ky. PSC June 20, 2005), and the Response to Staff's First Request, Item 7.

[18] Response to Staff's First Request, Item 7.

eliminated the need to separately report the Pre-2016 Compliance Plans and the 2016 Compliance Plan.[19] LG&E also proposes to create ES Form 2.01 to support the monthly amortization amounts and unamortized balances of projects included in the 2016 Compliance Plan.[20] The Commission finds reasonable LG&E's proposed revisions and additions to monthly ES forms.

OTHER ISSUES

To facilitate complete and timely reviews of LG&E's environmental surcharge mechanism, LG&E should ensure that any errors, when discovered, are identified and described in the cover letter of its monthly environmental surcharge report forms. LG&E should also disclose any corrective actions and the impact on its environmental surcharge.

IT IS THEREFORE ORDERED that:

1. LG&E'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 LG&E for the review period ended April 30, 2017, are just and reasonable.

3. In the second full billing month following the date of this Order, LG&E shall increase its jurisdictional environmental revenue requirement by $799,112 for four months and $799,113 for one month.

4. LG&E shall roll $52,893,140 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 $126,556,149. The roll-in shall be allocated to

[19] Rahn Testimony at 4.

[20] Response to Commission Staff's Third Request for Information, Item 2.b.

the customer classes as described in the Settlement Agreements approved in Case Nos. 2011-00162, 2011-00232, and 2016-00371.

5. LG&E shall use an overall rate of return on capital of 7.04 percent, a return-on-equity rate of 9.70 percent, a tax gross-up factor of 0.61334, and an overall grossed-up return of 10.34 percent in all monthly environmental surcharge filings beginning in the second full billing month following the date of this Order.

6. The proposed revisions and additions to LG&E's monthly ES forms are approved.

7. Within 20 days of the date of this Order, LG&E 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. 2011-00232; and a red-lined version of its tariffs.

By the Commission

ENTERED
DEC 19 2017
KENTUCKY PUBLIC SERVICE COMMISSION

ATTEST:

Executive Director for Gwen Pinson

*Honorable Allyson K Sturgeon
Senior Corporate Attorney
LG&E and KU Energy LLC
220 West Main Street
Louisville, KENTUCKY 40202

*Christopher M Garrett
Louisville Gas and Electric Company
220 W. Main Street
P. O. Box 32010
Louisville, KY 40202

*Derek Rahn
LG&E and KU Energy LLC
220 West Main Street
Louisville, KENTUCKY 40202

*Robert Conroy
LG&E and KU Energy LLC
220 West Main Street
Louisville, KENTUCKY 40202

*Louisville Gas and Electric Company
220 W. Main Street
P. O. Box 32010
Louisville, KY 40232-2010

*Louisville Gas and Electric Company
220 W. Main Street
P. O. Box 32010
Louisville, KY 40232-2010