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Commissioner

March 28, 2008

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CERTIFICATE OF SERVICE

RE: Case No. 2007-00379  
Kentucky Utilities Company

I, Stephanie Stumbo, Executive Director of the Public Service Commission, hereby certify that the enclosed attested copy of the Commission's Order in the above case was served upon the addressee by U.S. Mail on March 28, 2008.

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Executive Director

SS/rs  
Enclosure



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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 PERIOD ENDING OCTOBER 31, 2006	)	2007-00379
AND FOR THE TWO-YEAR BILLING PERIOD	)	
ENDING APRIL 30, 2007	)	

O R D E R

On September 19, 2007, the Commission initiated a 6-month review and a 2-year review of Kentucky Utilities Company's ("KU") environmental surcharge as billed to customers for the 6-month period May 1, 2006 to October 31, 2006 and the 2-year period May 1, 2005 to April 30, 2007.<sup>1</sup> Pursuant to KRS 278.183(3), the Commission must review, at 6-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 2-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.

The Attorney General, by and through his Office of Rate Intervention (AG"), and the Kentucky Industrial Utility Customers, Inc. ("KIUC") sought and were granted

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<sup>1</sup> KU's surcharge is billed on a 2-month lag. Thus surcharge billings for May 2006 through October 2006 are based on costs incurred from March 2006 through August 2006 and the amounts billed from May 2005 through April 2007 are based on costs incurred from March 2005 through February 2007.

intervention in this proceeding. The Commission issued a procedural schedule on September 19, 2007 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. The intervenors did not file requests for information or submit testimony. On December 12, 2007, KU filed a motion requesting that this case now be submitted for a decision based on the existing record of evidence without a hearing. KU's motion also stated that it had been authorized to represent that KIUC did not desire to submit further discovery, file testimony, or participate in a hearing.<sup>2</sup> On December 13, 2007, the AG filed a statement indicating he took no position on the case and deferred to the Commission regarding the appropriateness of the filing.<sup>3</sup> Based on KU's unopposed motion and finding good cause, the Commission will now adjudicate this case based on the evidence of record without a hearing.

#### SURCHARGE ADJUSTMENT

The September 19, 2007 Order initiating this case indicated that since each of the six periods 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. KU determined that it had a net under-recovery of its environmental costs for all the periods of \$1,699,755.<sup>4</sup> KU proposed that the net under-recovery be collected from customers over a 4-month period by increasing the total jurisdictional environmental surcharge revenue requirement by \$424,939 per month for

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<sup>2</sup> Motion of KU to Submit Case for Decision at 2-3.

<sup>3</sup> AG's Notice at 1.

<sup>4</sup> Conroy Direct Testimony at 4.

the first 3 months and \$424,938 for the fourth month beginning in the first billing month following the Commission's decision in this proceeding.<sup>5</sup>

The Commission has reviewed and finds reasonable KU's calculation of a net under-recovery of \$1,699,755 for the billing periods covered in this proceeding. The Commission also finds reasonable KU's proposal to increase the total jurisdictional environmental surcharge revenue requirement in each of the first 4 billing months following the date of this Order, with the increase in the first 3 months being \$424,939 and the increase in the fourth month being \$424,938. The Commission has estimated a customer with a \$100 electric bill would see an increase of approximately \$0.50 per month associated with the recovery of the net under-recovery during the 4-month period.

#### SURCHARGE ROLL-IN

KU proposed that it was appropriate in this case to incorporate surcharge amounts found just and reasonable for the 2-year billing period into existing base rates. KU recommended that this "roll-in" be in the amount of \$23,680,507.<sup>6</sup> KU determined the roll-in amount using the base-current methodology. The proposed roll-in will require the recalculation of the Base Environmental Surcharge Factor ("BESF") component of

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

<sup>6</sup> Id.

KU's surcharge mechanism.<sup>7</sup> Using the base revenues for the 12 months ending September 2007,<sup>8</sup> KU determined a BESF of 5.9833 percent. KU noted that in order to be consistent with the Commission's previous decisions in Case Nos. 2003-00068<sup>9</sup> and 2006-00129,<sup>10</sup> the BESF to be included in its surcharge mechanism would need to be calculated using base revenues for the 12-month period ending with the month preceding the month in which the Commission approved the roll-in.

The Commission has reviewed and finds it reasonable that \$23,680,507 from the surcharge should be rolled into existing base rates. The Commission also finds that KU should make a final determination of the BESF in a manner consistent with the Commission's decisions in Case Nos. 2003-00068 and 2006-00129 and submit its calculation of the BESF along with the first monthly surcharge filing submitted after the date of this Order.

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<sup>7</sup> The surcharge mechanism uses the following formula to calculate the surcharge factor:  $MESF = CESF - BESF$ . MESF is the Monthly Billed Environmental Surcharge Factor. CESF is the Current Period Environmental Surcharge Factor and reflects the environmental costs for the current expense month. The BESF reflects the portion of total eligible environmental surcharge revenue requirement that has been rolled into base rates.

<sup>8</sup> This period reflected the most current 12 months of base revenue information as of the date KU filed its direct testimony and was provided for illustrative purposes.

<sup>9</sup> Case No. 2003-00068, An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Utilities Company for the Six-Month Billing Periods Ending January 31, 2001, 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, rehearing Order dated May 4, 2004.

<sup>10</sup> Case No. 2006-00129, An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Utilities Company for the Six-Month Billing Periods Ending July 31, 2003, January 31, 2004, January 31, 2005, July 31, 2005, and January 31, 2006 and for the Two-Year Billing Period Ending July 31, 2004, final Order dated January 31, 2007.

### ALLOCATION OF ROLL-IN

KU proposed to follow the methodology approved by the Commission in Case No. 2006-00129, which allocates the roll-in amount to the customer classes on the basis of base-rate revenues. KU also proposed to follow the approach approved in Case No. 2006-00129 to assign the amount of the roll-in to the energy component of rate schedules with no separate demand charges and to the demand component for all rates that include a separately metered and billed demand component. Lighting rates would be billed on a per-light basis.<sup>11</sup>

The Commission has reviewed and finds reasonable KU's proposal to allocate the roll-in of \$23,680,507 on the basis of base-rate revenues. This approach is consistent with previous surcharge review cases where there has been a roll-in of the surcharge into existing base rates. The Commission also finds that KU's proposal concerning the assignment of the roll-in amounts to either the energy charge, demand charge, or on a per-light basis is reasonable and should be approved.

### RATE OF RETURN

KU stated that it believed the 10.50 percent rate of return on common equity ("ROE") established in Case No. 2006-00129 was the reasonable rate of return for environmental surcharge purposes. KU provided the outstanding balances for its long-term debt, short-term debt, and common equity as of February 28, 2007, the last billing month of the review periods. It also provided the blended interest rates for the long-

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<sup>11</sup> Response to the Commission Staff's First Data Request dated September 19, 2007, Item 11 and Revised Response to Item 11 filed October 24, 2007.



term debt and short-term debt as of February 28, 2007.<sup>12</sup> Using this information, KU calculated an overall rate of return on capital, before income tax gross-up, of 7.99 percent.<sup>13</sup> KU also provided the overall rate of return on capital reflecting the tax gross-up approach approved in Case No. 2004-00426.<sup>14</sup>

The Commission has reviewed KU's determination of the overall rate of return on capital and finds the 7.99 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 7.99 percent and the income tax gross-up factor of 0.5797 should be used in all KU monthly environmental surcharge filings subsequent to the date of this Order.

#### REPORTING FORMATS

KU proposed to include as part of the monthly filing forms ES Form 2.01, which shows the cost of limestone being used with the Ghent Unit 3 flue gas desulfurization equipment ("Scrubber"). The Ghent Unit 3 Scrubber was approved as part of the environmental compliance plan in Case No. 2004-00426 and the associated costs approved for recovery through the environmental surcharge. Since June 2007, KU has

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<sup>12</sup> Id., Item 12.

<sup>13</sup> Id.

<sup>14</sup> 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 dated June 20, 2005; and Response to the Commission Staff's First Data Request dated September 19, 2007, Item 12. In the response, KU determined that the income tax gross-up factor was 0.5797, which would produce a tax grossed-up weighted average cost of capital of 11.42 percent.

been reporting the cost of limestone in a supplemental attachment to the monthly surcharge filing. The Commission has reviewed the proposed format and finds it should be adopted and approved for use with KU's first monthly surcharge filing submitted after the date of this Order.

IT IS THEREFORE ORDERED that:

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

2. KU shall include a \$424,939 monthly increase in its jurisdictional environmental revenue requirement determined in the first 3 billing months following the date of this Order and \$424,938 in the fourth month following the date of this Order, as discussed herein.

3. KU shall roll into its existing base rates \$23,680,507 in environmental surcharge amounts found to be just and reasonable herein. The roll-in shall be allocated to the customer classes on the basis of base-rate revenues. The assignment of the roll-in amount to base rate components shall be as described herein.

4. KU shall calculate a revised BESF in a manner consistent with the Commission's Orders in Case Nos. 2003-00068 and 2006-00129. KU shall utilize the revised BESF in its first monthly surcharge filing submitted after the date of this Order and include all supporting calculations and workpapers used to determine the revised BESF.

5. KU shall use an overall rate of return on capital of 7.99 percent and a tax gross-up factor of 0.5797 in all monthly environmental surcharge filings subsequent to the date of this Order.

6. KU's proposed ES Form 2.01 is approved and shall be included with KU's first monthly surcharge filing submitted after the date of this Order.

Done at Frankfort, Kentucky, this 28th day of March, 2008.

By the Commission

Commission Clark Abstains.

ATTEST:

  
Executive Director