

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)	CASE NO. 2015-00020
UTILITIES COMPANY FOR THE SIX-MONTH)	
BILLING PERIODS ENDING APRIL 30, 2014)	
AND OCTOBER 31, 2014)	

ORDER

On January 20, 2015, the Commission initiated a six-month review of Kentucky Utilities Company's ("KU") environmental surcharge as billed to customers for the six-month periods beginning November 1, 2013, through April 30, 2014, and May 1, 2014, to October 31, 2014.¹ Pursuant to KRS 278.183(3), the Commission must review, at six-month intervals, the past operations of a utility's environmental surcharge. The Commission shall, by temporary adjustment of the surcharge, disallow any surcharge amounts that are not just and reasonable and reconcile past surcharge collections with actual costs recoverable pursuant to KRS 278.183(1).

The January 20, 2015 initiating Order also established a procedural schedule that provided for discovery, the filing of prepared testimony by KU, an informal conference, and intervenor testimony. KU filed prepared direct testimony and responded to requests for information issued by Commission Staff. On March 12, 2015,

¹ KU's environmental surcharge is billed on a two-month lag. Thus, surcharge billings for November 2013 through April 2014 are based on costs incurred from September 2013 through February 2014; and the surcharge billings for May 2014 through October 2014 are based on costs incurred from March 2014 through August 2014.

an informal conference was held at the Commission's offices to discuss the issues in this case. On May 6, 2015, KU requested that the Commission take this case under submission for decision based on the evidentiary record and issue an Order by May 29, 2015. Since there are no intervenors in this case and a hearing is not necessary in the public interest, the Commission will adjudicate this case based on the evidence of record.

SURCHARGE ADJUSTMENT

The January 20, 2015 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 over-recovery of environmental costs of \$1,478,110 for the billing periods ending April 30, 2014, and October 31, 2014.² KU recommended that the Commission approve a decrease to the jurisdictional environmental surcharge revenue requirement of \$739,055 for two months, beginning in the second full billing month following the Commission's final Order in this proceeding.³

KU's determination of its over-recovery for the review period reflects its election to take the 50 percent bonus tax depreciation for 2014, as allowed by the passage of the 2014 Tax Increase Prevention Act ("Act") in December 2014.⁴ KU stated that by taking the bonus tax depreciation, it incurred a tax loss for 2014 and therefore was not

² Direct Testimony of Robert M. Conroy, p. 6.

³ *Id.* at 8 and 9.

⁴ H. Res. 5771, 113th Cong. (2014) (enacted.) The Act extended 50 percent bonus tax depreciation for qualified property placed in service before January 1, 2015. Prior to the law change, only long-production-period property with construction commencing before 2014 was eligible for the 50 percent bonus tax depreciation deduction in 2014.

eligible for the Internal Revenue Code §199 manufacturing tax deduction. The §199 deduction is not available to companies that do not have taxable income. Because the §199 deduction is a component of the gross-up revenue factor calculation, it is necessary to reflect this change for the 2014 expense months in this review period.⁵ The effect of removing the §199 deduction is that the effective income tax rate is increased, thereby increasing the gross-up factor used in calculating the rate of return that is applied to the environmental rate base. KU states that the increase would be partially offset by the reduction of the environmental rate base, as the deferred income tax liability would be increased by the additional bonus tax depreciation. KU states that taking bonus depreciation provides the greatest benefit to customers over the life of the property. KU provided a Net Present Value Rate of Return calculation that indicated electing to take bonus tax depreciation results in a benefit of \$57.9 million over the life of the asset additions.⁶ The Commission has reviewed and finds reasonable KU's decision to elect to take bonus depreciation for 2014.

The Commission has reviewed and finds reasonable KU's calculation of a net over-recovery of \$1,478,110 for the billing periods covered in this proceeding. The Commission also finds reasonable KU's proposal to decrease the total jurisdictional environmental surcharge revenue requirement by \$739,055 for two months, 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 December 31,

⁵ January through August 2014.

⁶ KU's response to Commission Staff's Third Request for Information, Item 1.b.

2014, is 1,247 kilowatt hours (“kWh”) per month.⁷ KU calculates that for a residential customer using 1,247 kWh per month, the impact of its proposed adjusted environmental cost recovery billing factor would be a decrease of approximately \$.65 per month, using rates and adjustment clause factors in effect for the December 2014 billing month.⁸

RATE OF RETURN

KU provided the outstanding balances for its long-term debt, short-term debt, and common equity as of August 31, 2014, the last expense month of the review period.⁹ It also provided the blended interest rates for its long-term and short-term debt as of August 31, 2014.¹⁰ Using this information, along with the currently approved 10.25 percent return on equity,¹¹ KU calculated an overall rate of return on capital, before income tax gross-up, of 7.11 percent for its Compliance Plans.¹² KU also provided the overall rate of return on capital reflecting the tax gross-up approach approved in Case No. 2004-00426.¹³

⁷ KU's response to Commission Staff's First Request for Information (“Staff's First Request”), Item 6.

⁸ *Id.*

⁹ KU's response to Staff's First Request, Item 5.a.

¹⁰ *Id.* at Item 5.b.

¹¹ Case No. 2012-00221, *Application of Kentucky Utilities Company for an Adjustment of Its Electric Rates* (Ky. PSC Dec. 20, 2012).

¹² KU's response to Staff's First Request, Item 5.c.

¹³ 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 and Recovery by Environmental Surcharge* (Ky. PSC June 20, 2005); and KU's response to Staff's First Request, Item 5.c. In the response, KU determined that the income tax gross-up factor was 0.643063, which would produce a tax grossed-up weighted average cost of capital of 10.15 percent.

KU recommends that an income tax rate reflecting the §199 manufacturing tax deduction be used for the gross-up factor in the rate of return calculation, as this will lower the environmental revenue requirement. KU states that this approach is consistent with its recommendation in its current base rate case proceeding¹⁴ to opt out of taking bonus tax depreciation in 2015 in order to provide the greatest benefit to customers.

The Commission has reviewed KU's calculation of the overall rate of return on capital and finds that its use of 7.11 percent is reasonable for the Compliance Plans and should be approved. The Commission has also reviewed KU's calculation 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 for KU's Compliance Plans of 7.11 percent and the income tax gross-up factor of 0.643063, which together produce an overall grossed-up return of 10.15 percent, should be used in all KU monthly environmental surcharge filings beginning in the second full billing month following the date of this Order.

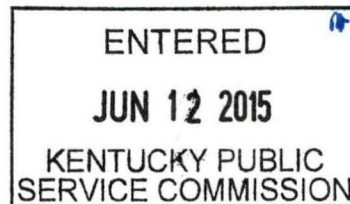
IT IS THEREFORE ORDERED that:

1. The amounts billed to customers by KU through its environmental surcharge for the period from November 1, 2013, through April 30, 2014, and May 1, 2014, through October 31, 2014, are approved.
2. In the second full billing month following the date of this Order, KU shall decrease its jurisdictional environmental revenue requirement by \$739,055 for two months.

¹⁴ Case No. 2014-00371, *Application of Kentucky Utilities Company for an Adjustment of Its Electric Rates* (Ky. PSC filed Nov. 26, 2014.)

3. Beginning in the second full billing month following the date of this Order, KU shall use an overall rate of return on capital of 7.11 percent, a tax gross-up factor of 0.643063, a return on equity rate of 10.25 percent, and an overall grossed-up return of 10.15 percent in all future monthly environmental surcharge filings unless directed otherwise by the Commission.

By the Commission



ATTEST:


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