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 LOUISVILLE GAS AND ELECTRIC COMPANY FOR THE SIX-MONTH BILLING PERIODS ENDING APRIL 30, 2014 AND OCTOBER 31, 2014	))))))	CASE NO. 2015-00021

ORDER

On January 20, 2015, the Commission initiated a six-month review of Louisville Gas and Electric Company's ("LG&E") environmental surcharge as billed to customers for the six-month periods beginning November 1, 2013, to April 30, 2014, and May 1, 2014, through 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 LG&E, an informal conference, and intervenor testimony. LG&E filed prepared direct testimony and responded to requests for information issued by Commission Staff. On March 12, 2015,

[1] LG&E'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, LG&E 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. LG&E determined that it had a net over-recovery of environmental costs of $326,442[2] for the billing periods ending April 30, 2014, and October 31, 2014. LG&E recommended that the Commission approve a decrease to the environmental surcharge revenue requirement of $326,422 for one month, which would be the second full billing month following the Commission's Order in this proceeding.[3]

LG&E'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] LG&E stated that by taking the bonus tax depreciation, it incurred a tax loss for 2014 and

[2] Revised Direct Testimony of Robert M. Conroy, p. 6, filed April 2, 2015.

[3] *Id.* at 10.

[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.

therefore was not 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. LG&E 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. LG&E states that taking bonus depreciation provides the greatest benefit to customers over the life of the property. LG&E provided a Net Present Value Rate of Return calculation that indicated electing to take bonus tax depreciation results in a benefit of $30.9 million over the life of the asset additions.[6] The Commission has reviewed and finds reasonable LG&E's decision to elect to take bonus depreciation for 2014.

The Commission has reviewed and finds reasonable LG&E's calculation of a net over-recovery of $326,442 for the billing periods covered in this proceeding. The Commission also finds reasonable LG&E's proposal to decrease the total jurisdictional environmental surcharge revenue requirement by $326,442 for the one billing month mentioned above. LG&E stated that the actual average residential customer's usage for the 12 months ending December 31, 2014, is 984 kilowatt hours ("kWh") per month.[7]

---

[5] January through August 2014.

[6] LG&E's response to Commission Staff's Third Request for Information, item 1.b.

[7] LG&E's response to Commission Staff's First Request for Information ("Staff's First Request"), Item 6.

LG&E calculates that, for a residential customer using 984 kWh per month, the impact of its proposed adjusted environmental cost recovery billing factor would be a one month decrease of approximately $.37, using rates and adjustment clause factors in effect for the December 2014 billing month.[8]

RATE OF RETURN

LG&E 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] LG&E calculated an overall rate of return on capital, before income tax gross-up, of 7.04 percent for its Compliance Plans.[12] LG&E also provided the overall rate of return on capital reflecting the tax gross-up approach approved in Case No. 2004-00421.[13]

LG&E 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

---

[8] *Id.*

[9] LG&E's response to Staff's First Request, Item 5.a.

[10] *Id.* at Item 5.b.

[11] Case No. 2012-00222, *Application of Louisville Gas and Electric Company for an Adjustment of Its Electric and Gas Rates, a Certificate of Public Convenience and Necessity, Approval of Ownership of Gas Service Lines and Risers, and a Gas Line Surcharge* (Ky. PSC Dec. 20, 2012).

[12] LG&E's response to Staff's First Request, Item 5.c.

[13] 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 LG&E's response to Staff's First Request, Item 5.c. In the response, LG&E determined that the income tax gross-up factor was 0.643063, which would produce a tax grossed-up weighted average cost of capital of 10.07 percent.

lower the environmental revenue requirement. LG&E states that it will reassess its 2015 tax position in the next environmental surcharge review to determine whether an adjustment of its income tax rate is necessary to reflect any decision to elect or opt-out of taking bonus tax depreciation for 2015.

The Commission has reviewed LG&E's calculation of the overall rate of return on capital and finds that its use of 7.04 percent is reasonable for the Compliance Plans and should be approved. The Commission has also 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 Therefore, the Commission finds that the weighted average cost of capital for LG&E's Compliance Plans of 7.04 percent and the income tax gross-up factor of 0.643063, which together produce an overall grossed-up return of 10.07 percent, should be used in all of LG&E's monthly environmental surcharge filings beginning in the second full month following the date of this Order.

IT IS THEREFORE ORDERED that:

1. The amounts billed to customers by LG&E 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, LG&E shall decrease its jurisdictional environmental revenue requirement by $326,442 for two months.

3. Beginning in the second full billing month following the date of this Order, LG&E shall use an overall rate of return on capital of 7.04 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 10.07 percent in all future monthly environmental surcharge filings unless directed otherwise by the Commission.

By the Commission

ENTERED

JUN 12 2015

KENTUCKY PUBLIC SERVICE COMMISSION

ATTEST:

Aaron D. Greenwell for

Executive Director

*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

*Rick E Lovekamp
Manager - Regulatory Affairs
LG&E and KU Energy LLC
220 West Main Street
Louisville, KENTUCKY 40202

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

*Ed Staton
VP - State Regulation and Rates
Louisville Gas and Electric Company
220 W. Main Street
P. O. Box 32010
Louisville, KY 40202

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