

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)	CASE NO.
AND ELECTRIC COMPANY FOR THE SIX-MONTH)	2015-00412
BILLING PERIOD ENDING OCTOBER 31, 2015)	

ORDER

On December 21, 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 period beginning May 1, 2015, through October 31, 2015.¹ Pursuant to KRS 278.183(3), the Commission must review, at six-month intervals, the past operations of a utility's environmental surcharge. Also, pursuant to KRS 278.183(1), 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.

The December 21, 2015 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 a request for information issued by Commission Staff. On February 4, 2016, an informal conference was held at the Commission's offices to discuss the issues in this case. On March 4, 2016, LG&E requested that the Commission take this

¹ LG&E's environmental surcharge is billed on a two-month lag. Thus, surcharge billings for May 2015 through October 2015 are based on costs incurred from March 2015 through August 2015.

case under submission for decision based on the evidentiary record and issue an Order by March 31, 2016. 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

LG&E determined that it had a net over-recovery of environmental costs for the six-month billing period ended October 31, 2015, of \$1,702,207.² LG&E recommended that the Commission approve a decrease to the jurisdictional environmental surcharge revenue requirement of \$567,402 per month for two months and \$567,403 for one month, beginning in the second full billing month following the Commission's Final Order in this proceeding.³ The three-month decrease in jurisdictional environmental surcharge revenue requirement would be achieved by decreasing LG&E's environmental cost recovery billing factor for those same months.

The Commission has reviewed and finds reasonable LG&E's calculation of a net over-recovery of \$1,702,207 for the six-month billing period covered in this proceeding. The Commission also finds reasonable LG&E's proposal to refund this over-recovery by decreasing the total jurisdictional environmental surcharge revenue requirement by \$567,402 per month for two months and \$567,403 for one month, beginning in the second full billing month following the date of this Order. LG&E stated that the actual average residential customer's usage for the 12 months ended November 30, 2015, is

² Direct Testimony of Derek A. Rahn at 5.

³ *Id.* at 7.

976 kilowatt hours (“kWh”) per month.⁴ LG&E calculates that for a residential customer using 976 kWh per month, the impact of its proposed decrease in the environmental cost recovery billing factor would be a decrease of approximately \$0.62 per month for three months, using rates and adjustment clause factors in effect for the November 2015 billing month.⁵

RATE OF RETURN

LG&E provided the outstanding balances for its long-term debt, short-term debt, and common equity as of August 31, 2015, the last expense month of the review period.⁶ It also provided the blended interest rates for its long-term and short-term debt as of August 31, 2015.⁷ Using this information, along with the currently approved 10 percent return on equity,⁸ LG&E calculated a weighted average cost of capital, before income tax gross-up, of 6.75 percent for its 2009 and 2011 Environmental Compliance Plans (“Compliance Plans”).⁹ LG&E also provided the overall rate of return on capital reflecting the tax gross-up approach approved in Case No. 2004-00421.¹⁰

⁴ LG&E’s corrected response to Commission Staff’s First Request for Information (filed Jan. 19, 2016) (“Staff’s First Request”), Item 6.

⁵ *Id.*

⁶ LG&E’s revised response to Staff’s First Request (filed Feb. 3, 2016), Item 5.

⁷ *Id.*

⁸ Case No. 2014-00372, *Application of Louisville Gas and Electric Company for an Adjustment of Its Electric and Gas Rates* (Ky. PSC June 30, 2015).

⁹ LG&E’s revised response to Staff’s First Request, Item 5.

¹⁰ 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 revised response to Staff’s First Request, Item 5. In the response, LG&E determined that the income tax gross-up factor was 0.61, which would produce a tax grossed-up weighted average cost of capital of 10.10 percent.

The Commission has reviewed LG&E's calculation of the weighted average cost of capital and finds that its use of 6.75 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. The gross-up factor excludes the Internal Revenue Code §199 manufacturing tax deduction ("§199 deduction") because LG&E incurred a tax loss for 2015 by taking bonus depreciation. The §199 deduction is not available to companies that do not have taxable income. Therefore, the Commission finds that the weighted average cost of capital for LG&E's Compliance Plans of 6.75 percent and the income tax gross-up factor of 0.61, which produces an overall grossed-up return of 10.10 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.

IT IS THEREFORE ORDERED that:

1. The amounts billed to customers by LG&E through its environmental surcharge for the period from May 1, 2015, through October 31, 2015, are approved.
2. Beginning in the second full billing month following the date of this Order, LG&E shall decrease its jurisdictional environmental revenue requirement by \$567,402 per month for two months and \$567,403 for one month.
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 6.75 percent, a tax gross-up factor of 0.61, a return on equity rate of 10.00 percent, and an overall grossed-up return of 10.10 percent in all future monthly environmental surcharge filings, unless directed otherwise by the Commission.

By the Commission

ENTERED
MAR 16 2016
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

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