

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 EAST KENTUCKY	)	
POWER COOPERATIVE, INC. FOR THE SIX-MONTH	)	CASE NO.
BILLING PERIOD ENDING JUNE 30, 2016, AND THE	)	2016-00335
PASS THROUGH MECHANISM FOR ITS SIXTEEN	)	
MEMBER DISTRIBUTION COOPERATIVES	)	

ORDER

On October 12, 2016, the Commission initiated a six-month review of East Kentucky Power Cooperative, Inc.'s ("EKPC") environmental surcharge<sup>1</sup> as billed to its member distribution cooperatives ("Member Cooperatives") for the six-month period of January 1, 2016, to June 30, 2016.

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 found not to be just and reasonable; and reconcile past surcharges with actual costs recoverable. The October 12, 2016 Order also initiated a six-month review of the 16 EKPC Member Cooperatives' pass-through mechanism<sup>2</sup> as billed to

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<sup>1</sup> EKPC's environmental surcharge was initially approved in Case No. 2004-00321, *Application of East Kentucky Power Cooperative, Inc. for Approval of an Environmental Compliance Plan and Authority to Implement an Environmental Surcharge* (Ky. PSC Mar. 17, 2005).

<sup>2</sup> Case No. 2004-00372, *Application of Big Sandy RECC, Blue Grass Energy Cooperative Corporation, Clark Energy Cooperative, Cumberland Valley Electric, Inc., Farmers RECC, Fleming-Mason Energy Cooperative, Inc., Grayson RECC, Inter-County Energy Cooperative Corporation, Jackson Energy Cooperative Corporation, Licking Valley RECC, Nolin RECC, Owen Electric Cooperative, Inc., Salt River Electric Cooperative Corporation, Shelby Energy Cooperative, Inc., South Kentucky RECC, and Taylor County RECC for Authority to Pass Through the Environmental Surcharge of East Kentucky Power Cooperative, Inc.* (Ky. PSC Mar. 17, 2005).

their retail member customers for the six-month period January 1, 2016, to June 30, 2016.<sup>3</sup>

The Commission issued a procedural schedule that provided for two rounds of discovery, the filing of prepared testimony, an informal conference, and intervenor testimony. On November 9, 2016, an informal conference was held at the Commission's offices to allow EKPC and several of its Member Cooperatives an opportunity to discuss issues related to EKPC's environmental surcharge mechanism and the Member Cooperatives' pass-through mechanism. EKPC filed prepared direct testimony and responded to two requests for information. The Member Cooperatives filed prepared direct testimony and responded to two requests for information. No parties requested intervenor status to this proceeding. On February 3, 2017, EKPC filed a motion stating that EKPC and the Member Cooperatives believed the case record is complete and this case may be submitted for decision on the current record without a hearing, unless a hearing would assist the Commission in its consideration of EKPC's flat-rate methodology.

#### SURCHARGE ADJUSTMENT

EKPC determined that it had a net over-recovery of \$343,125<sup>4</sup> for the period under review due to reporting errors in operating and maintenance ("O&M") expenses,

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<sup>3</sup> The Settlement Agreement approved in Case Nos. 2004-00321 and 2004-00372 allows the Member Cooperatives to pass through the environmental surcharge to their customers at approximately the same time EKPC bills the environmental surcharge to the Member Cooperatives, thus avoiding a billing lag for the Member Cooperatives. Therefore, the costs incurred from November 2015 through April 2016 are billed to the Member Cooperatives in the months of January 2016 through June 2016, with these same costs passed through to customers on their bills for January 2016 through June 2016.

<sup>4</sup> EKPC's Response to Commission Staff's First Request for Information ("Staff's First Request"), Item 1 at 2.

first identified in Case No. 2015-00281,<sup>5</sup> that impacted the expense months of December 2014 through February 2016. Case No. 2015-00281 addressed the expense months of December 2014 through May 2015, and Case No. 2016-00144<sup>6</sup> addressed the expense months of June 2015 through November 2015. The instant case addresses the remaining expense months of December 2015 through February 2016. EKPC proposes to return the over-recovery in the first two months following the Commission's Order in this proceeding as an adjustment on Line 11 of ES Form 1.1 of \$171,562 for one month and \$171,563 for the following month.<sup>7</sup> The Commission has reviewed and finds reasonable EKPC's calculation of its net over-recovery of \$343,125 for the review period covered in this proceeding. The Commission also finds reasonable EKPC's proposal to return the over-recovery as an adjustment on Line 11 of ES Form 1.1 of the monthly environmental surcharge filing in the first two billing months following the date of this Order.

#### RATE OF RETURN

The Settlement Agreement approved in Case No. 2004-00321 provided that the rate of return would be based on a weighted average debt cost of the debt issuances directly related to the projects in EKPC's compliance plan, multiplied by a Times Interest Earned Ratio ("TIER") factor. The Settlement Agreement further provided that EKPC

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<sup>5</sup> Case No. 2015-00281, *An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of East Kentucky Power Cooperative, Inc. for the Six-Month Billing Periods Ending June 30, 2014 and December 31, 2014, for the Two-Year Billing Period Ending June 30, 2015, and the Pass Through Mechanism for Its Sixteen Member Distribution Cooperatives* (Ky. PSC Apr. 8, 2016).

<sup>6</sup> Case No. 2016-00144, *An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of East Kentucky Power Cooperative, Inc. for the Six-Month Billing Period Ending December 31, 2015, and the Pass Through Mechanism for Its Sixteen Member Distribution Cooperatives* (Ky. PSC Sept. 9, 2016).

<sup>7</sup> Direct Testimony of Isaac S. Scott ("Scott Testimony") at 14.

update the return as of the end of each six-month review period and request Commission approval of the updated average cost of debt.<sup>8</sup>

EKPC calculated a weighted average cost of debt as of May 31, 2016, of 4.039 percent. EKPC determined the rate of return utilizing the TIER factor of 1.50 authorized in Case No. 2011-00032.<sup>9</sup> Utilizing these components, EKPC calculated an updated rate of return of 6.059 percent as of May 31, 2016. EKPC proposed that an overall rate of return of 6.059 percent be used starting with the first month following the final Order in this case.<sup>10</sup>

The Commission has reviewed and finds reasonable EKPC's determination of the updated rate of return of 6.059 percent reflecting the updated weighted average cost of debt of 4.039 percent and a 1.50 TIER factor. The Commission finds that EKPC should use a rate of return of 6.059 percent for all environmental surcharge monthly filings submitted after the date of this Order.

#### RETAIL PASS-THROUGH MECHANISM

Each of the Member Cooperatives determined an over- or under-recovery for its surcharge pass-through mechanism, with nine of the Member Cooperatives having over-recoveries and seven of the Member Cooperatives having under-recoveries. The Member Cooperatives' over- or under-recoveries were determined utilizing the revised calculation methodology approved in Case No. 2015-00281. EKPC stated that the

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<sup>8</sup> Case No. 2004-00321, *East Kentucky Power Cooperative, Inc.* (Ky. PSC Mar. 17, 2005), Order, Appendix A at 3.

<sup>9</sup> Case No. 2011-00032, *An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of East Kentucky Power Cooperative, Inc. for the Six-Month Billing Period Ending December 31, 2010; and the Pass-Through Mechanism for Its Sixteen Member Distribution Cooperatives* (Ky. PSC Aug. 2, 2011).

<sup>10</sup> EKPC's Response to Staff's First Request, Item 5 at 2.

Member Cooperatives proposed that the over-recoveries be refunded to, or the under-recoveries be collected from, ratepayers as an adjustment to the retail pass-through factor for each month in the six-month period following the Commission's Order in this proceeding.<sup>11</sup>

The Commission has reviewed and finds reasonable each of the Member Cooperatives' calculations of their respective over-recoveries and under-recoveries for the review periods covered in this proceeding. The Commission finds reasonable the Member Cooperatives' proposals to amortize their respective accumulated over- or under-recovery amounts in each of the first six billing months following the final Order in this proceeding. A schedule of the over- or under-recovery for each Member Cooperative and the related monthly adjustments is shown in the Appendix to this Order. The impact of the over- or under-recovery on an average residential customer's monthly bill for each respective Member Cooperative is also indicated.

EKPC determines the Member Cooperatives' monthly pass-through factors using the monthly over- or under-recovery amortization amounts as stated in the Appendix to the Orders authorizing the return or collection of the over- or under-recovery. Because the total over- or under-recoveries authorized are not always evenly divisible by six, small dollar amounts remain to be amortized due to rounding differences. EKPC proposes that the amortization amounts approved in Case No. 2014-00051<sup>12</sup> be

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<sup>11</sup> EKPC's Response to Staff's First Request, Item 2 at 1.

<sup>12</sup> Case No. 2014-00051, *An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of East Kentucky Power Cooperative, Inc. for the Six-Month Billing Period Ending December 31, 2013 and the Pass Through Mechanism for Its Sixteen Member Distribution Cooperatives* (Ky. PSC Aug. 25, 2015).

considered completed and closed.<sup>13</sup> Farmers Rural Electric Cooperative Corporation (“Farmers”) and Owen Electric Cooperative (“Owen”) were authorized to use a 12-month amortization for Case No. 2014-00051, and as such, their amortization was not completed as of this review. EKPC proposes to address any rounding differences for Farmers and Owen in the same manner during the next six-month surcharge review. A similar situation will occur when the amortization of the over- or under-recovery amounts authorized in Case No. 2015-00281 is completed. EKPC proposes to treat the rounding differences in amortization amounts authorized in Case No. 2015-00281 in the same manner as those authorized in Case No. 2014-00051.<sup>14</sup> Owen was also granted a 12-month amortization period in Case No. 2015-00281.

To avoid residual rounding differences for the amortization of the over- or under-recoveries authorized in Case No. 2016-00144 and subsequent review cases, EKPC proposes to compare the first five monthly amortization amounts with the total amortization ordered by the Commission and adjust the sixth-month amount to resolve any rounding issues. EKPC proposes to follow this approach for all subsequent amortization periods.<sup>15</sup> The Commission finds reasonable EKPC’s proposed treatment of rounding differences in the Member Cooperatives’ over- or under-recovery amortization amounts.

#### SURCHARGE CALCULATION METHODOLOGY

During the last several review cases, EKPC and the Member Cooperatives have expressed concern regarding the variability in EKPC’s surcharge factor and

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<sup>13</sup> EKPC’s Response to Staff’s First Request, Item 2 at 2

<sup>14</sup> *Id.* at 3.

<sup>15</sup> *Id.*

consequently the Member Cooperatives' pass-through factors. The Member Cooperatives indicated that volatility in the environmental surcharge could affect their cash flows, margins, and financial measures such as TIER, and create difficulty explaining fluctuations in surcharge amounts to retail customers.<sup>16</sup> Previous attempts to address surcharge factor volatility have focused on the Member Cooperatives' pass-through factor calculation. Two alternative methodologies to address these concerns were considered in this case.

Direct billing methodology. The October 12, 2016 Order initiating this case directed EKPC to provide additional testimony regarding whether EKPC had considered billing the environmental costs as a direct amount. Under this approach, EKPC would divide the total costs recoverable proportionally among the Member Cooperatives based on wholesale sales. EKPC would assign a dollar amount to each Member Cooperative instead of applying a surcharge percentage to the Member Cooperatives' bills.

EKPC states that it has not considered billing a direct amount and raises its concerns with this approach. EKPC argues that a direct billing approach is not supported by the plain meaning of the environmental surcharge statute, KRS 278.183, which specifies a "rate surcharge."<sup>17</sup> EKPC contends that the direct billing method would assign costs based on a Member Cooperative's relative position in EKPC's total monthly wholesale sales instead of the unique customer mix and load characteristics of the Member Cooperative.<sup>18</sup> EKPC further reasons that the direct billing method is not supported by the Commission's history with either the environmental surcharge or

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<sup>16</sup> Informal Conference Memorandum dated November 14, 2016.

<sup>17</sup> Scott Testimony at 17.

<sup>18</sup> *Id.* at 16-17.



various other surcharges, as no utility has requested a direct charge, and given that, for example, Demand Side Management, Home Energy Assistance, and Accelerated Main Replacement Program surcharges are all rate surcharges.<sup>19</sup> Furthermore, EKPC states that the direct billing method would neither eliminate over- or under-recoveries nor result in more immediate recovery of environmental costs, because any averaging or leveling mechanism put in place to reduce the effect of volatility in wholesale sales would create over- or under-recoveries. This would result in environmental costs that are recovered in the same period as the current methodology.<sup>20</sup>

Despite EKPC's expressed concerns, the Commission believes that, with the proper parameters, the direct billing methodology will comply with KRS 278.183, result in immediate recovery of EKPC's environmental costs without the need for over- or under-recoveries, and reduce the volatility in the Member Cooperatives' pass-through factors. However, the detailed mechanics of this methodology have not been fully developed, would need more evaluation to be a practicable alternative to the current methodology, and will not be considered further in this proceeding.

Flat-rate methodology. EKPC subsequently proposed using a flat rate to calculate surcharges by dividing the budgeted yearly environmental revenue requirement by the budgeted yearly revenues subject to the surcharge. As proposed, the factor would be calculated yearly and applied to the Member Cooperatives' bills for the year. Any over- or under-recovery would be included in the calculation of the next year's surcharge factor. The budgeted revenue requirement would include only the projects approved at the time the surcharge is calculated. Any newly approved projects

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<sup>19</sup> *Id.* at 18.

<sup>20</sup> *Id.* at 19–20.



or plant retirements would be included in the over- or under-recovery calculation for the year. The budgeted revenue requirement for the next year would include the new projects or retirements. EKPC would continue to file monthly surcharge reports for the purposes of calculating the over- or under-recovery and assisting in the review of the reasonableness of the surcharge amounts.<sup>21</sup> There would be no change to the Member Cooperatives' pass-through factor calculation.<sup>22</sup>

In support of the flat-rate methodology, EKPC argued that, while the environmental revenue requirement is relatively constant, the monthly wholesale revenues subject to surcharge, and thus the over- or under-recovery, fluctuate significantly.<sup>23</sup> This fluctuation creates volatility in EKPC's surcharge factor and, consequently, the Member Cooperatives' pass-through factors. The Member Cooperatives have previously tried to combat the volatility through changes to their own factor calculation. Billing the environmental surcharge as a constant percentage of Member Cooperatives' bills for the year would result in less volatile pass-through factors to the retail customers and would eliminate volatility for retail customers on direct-serve rate schedules.

EKPC argues that the flat rate is in keeping with KRS 278.183 because the current volatility is caused by the over- or under-recovery amounts that are not true "costs," and because the Commission has been flexible before with interpretation of

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<sup>21</sup> *Id.* at 23–24.

<sup>22</sup> *Id.* at 24.

<sup>23</sup> *Id.* at 23.

statutes.<sup>24</sup> Because the revenue requirement does not fluctuate significantly, using budgeted amounts for the calculation of the flat rate should result in recovery of approximately EKPC's actual costs. The over/under-recovery mechanism would still "true-up" the actual expenses incurred and revenues collected.

EKPC states that the adoption of the flat-rate approach would require a modification of its rate ES – Environmental Surcharge tariff.<sup>25</sup> Changes would be required to the definition of the current environmental surcharge factor to reflect: 1) the use of the flat-rate approach; 2) that the monthly calculation of environmental costs is for determining the over- or under-recovery; and 3) the removal of references to the one-month true-up adjustment and the calculation of a current monthly surcharge factor. EKPC provided proposed tariff sheets that reflect the flat-rate methodology. No changes would be required for the Member Cooperatives' environmental surcharge tariffs because of the flat-rate approach. EKPC proposes to begin utilizing the flat-rate methodology for the expense month of March 2017, because beginning the methodology change in such a lower-usage month would minimize the effect on the Member Cooperatives.<sup>26</sup>

While the flat-rate methodology would alleviate volatility in EKPC's environmental surcharge factor and the Member Cooperatives' pass-through factors, it is contrary to KRS 278.183(1), which provides for the costs recoverable through the environmental surcharge, and KRS 278.183(2), which directs how the costs are to be recovered. KRS 278.183(1) provides that "a utility shall be entitled to the current recovery of its costs."

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<sup>24</sup> EKPC's Response to Commission Staff's Second Request for Information ("Staff's Second Request"), Item 1.a.

<sup>25</sup> Scott Testimony at 25

<sup>26</sup> EKPC's Response to Staff's Second Request, Item 1.b.

KRS 278.183(2) specifies these costs shall be “imposed as a positive or negative adjustment to customer bills in the *second month following the month in which costs are incurred.*” (Emphasis added.) The proposed flat-rate methodology would not allow for the current recovery of environmental compliance costs pursuant to KRS 278.183(1), or recovery of costs “in the second month following the month in which the costs are incurred” pursuant to KRS 278.183(2) and, therefore, does not comply with the environmental surcharge statute. While the flat-rate methodology may reduce volatility because it bills a yearly average of environmental costs, it does not bill for the specific costs in the second month after the charges were incurred, would be unlawful, and should not be approved.

IT IS THEREFORE ORDERED that:

1. The amounts billed by EKPC through its environmental surcharge for the period January 1, 2016, to June 30, 2016, are approved.

2. EKPC's determination that it experienced a net over-recovery of \$343,125 for the review period is approved. Beginning in the first full-billing month following the date of this Order, EKPC shall decrease its jurisdictional environmental revenue requirement by \$171,562 per month for one month and \$171,563 for one month.

3. EKPC shall use a rate of return of 6.059 percent in all monthly environmental surcharge filings subsequent to the date of this Order.

4. EKPC's Member Cooperatives shall include the applicable monthly retail pass-through adjustments, shown in the Appendix to this Order, in the determination of each Member Cooperative's respective pass-through mechanism in each of the first six months following the date of this Order, as discussed herein.

5. EKPC's proposed treatment of rounding differences in the Member Cooperatives' amortization of their over- or under-recovery amounts is approved.

6. EKPC's proposed change to a flat-rate billing factor to begin with the expense month of March 2017 is denied.

7. EKPC's proposed changes to its rate ES – Environmental Surcharge tariff are denied.

By the Commission

ENTERED  
MAY 11 2017  
KENTUCKY PUBLIC  
SERVICE COMMISSION

ATTEST:

  
Executive Director

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2016-00335 DATED **MAY 11 2017**

Member Cooperatives' Adjustments to  
Monthly Pass-Through Mechanism

The EKPC Member Cooperatives shall include the following monthly adjustments in the determination of the applicable pass-through factors for the first six months after the date of this Order.

	<b>Total Amount of Over-Recovery</b>	<b>Monthly Amount To Be Returned</b>	<b>Monthly Bill Impact</b>
Big Sandy RECC	\$11,591	\$1,932	\$0.12
Blue Grass Energy Cooperative	\$85,336	\$14,223	\$0.18
Cumberland Valley Electric	\$64,625	\$10,771	\$0.34
Farmers RECC	\$53,503	\$8,917	\$0.26
Fleming-Mason Energy Cooperative	\$47,025	\$7,838	\$0.25
Jackson Energy Cooperative	\$306,753	\$51,126	\$0.88
Salt River Energy Cooperative Corp.	\$101,226	\$16,871	\$0.23
Shelby Energy Cooperative	\$11,360	\$1,893	\$0.08
South Kentucky RECC	\$109,641	\$18,274	\$0.20

	<b>Total Amount of Under-Recovery</b>	<b>Monthly Amount To Be Collected</b>	<b>Monthly Bill Impact</b>
Clark Energy Cooperative	\$32,040	\$5,340	\$0.16
Grayson RECC	\$5,951	\$992	\$0.06
Inter-County Energy Cooperative Corp.	\$1,095	\$183	\$0.01
Licking Valley RECC	\$1,813	\$302	\$0.26
Nolin RECC	\$12,072	\$2,012	\$0.04
Owen Electric Cooperative	\$269,152	\$44,859	\$0.30
Taylor County RECC	\$11,999	\$2,000	\$0.05

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