COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF LOUISVILLE GAS AND ELECTRIC COMPANY FOR APPROVAL OF COMPLIANCE PLAN AND TO ASSESS A SURCHARGE PURSUANT TO KRS 278.183 TO RECOVER COSTS OF COMPLIANCE WITH ENVIRONMENTAL REQUIREMENTS FOR COAL COMBUSTION WASTES AND BY-PRODUCTS	)	CASE NO. 94-332

O R D E R

The Louisville Gas and Electric Company ("LG&E") and the Attorney General's Office, Public Service Litigation Branch ("AG") filed applications for rehearing of the Commission's April 6, 1995 Order authorizing LG&E an environmental surcharge.

LG&E challenges the requirement to calculate the surcharge on total revenue, urging that its proposal to use retail revenue only be adopted. LG&E contends that the inclusion of off-system sales revenue in the surcharge denies it the opportunity to recover eligible environmental compliance expenditures and is contrary to the Commission's treatment of off-system sales revenues and expenses in LG&E's last rate case, Case No. 90-158.[1]

The Commission's decision to calculate the surcharge on total revenue comports with both the letter and spirit of the law. By enacting the environmental surcharge statute, the General Assembly made a policy decision that eligible environmental costs should be recovered from retail ratepayers on an expedited basis without the

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[1] Case No. 90-158, Adjustment of Gas and Electric Rates of Louisville Gas and Electric Company.

need for a general rate application. However, nothing in the statute indicates an intent to require retail ratepayers to shoulder the environmental costs attributable to wholesale, off-system sales which are not subject to regulation by this Commission.

In Case No. 90-158, the Commission did allocate all off-system sales revenues and expenses to retail ratepayers, with the net result of that process being a reduction to the retail cost of service. By invoking KRS 278.183, LG&E has foreclosed a review of its off-system sales revenue, while proposing to charge off-system sales expenses to retail ratepayers. This proposal would upset the balance of benefits derived from off-system sales being credited to retail ratepayers in Case No. 90-158. Rate recovery of eligible environmental costs attributable to off-system sales is appropriate only in a general rate application under KRS 278.190 where all revenues and expenses are subject to full scrutiny.

Contrary to LG&E's claim, this decision does not deny it an opportunity to recover the environmental costs attributable to off-system sales. Those costs may be recovered either in the wholesale price for such sales or by filing a general rate application. In any event, LG&E has failed to demonstrate that its rates for off-system sales are insufficient to recover the eligible environmental costs attributable to such sales.

The AG seeks rehearing on five issues. The first is a challenge to the Commission's interpretation of KRS 278.183 as prohibiting a review of the sufficiency or insufficiency of

existing rates to determine whether an environmental surcharge should be authorized. The AG argues that such an interpretation is "absurd and unreasonable" and that the environmental surcharge statute must be read in light of the general rate adjustment statute to ensure that a utility does not earn an excessive return.

The Commission fully agrees that no utility should earn an excessive return. However, the plain and unambiguous language of KRS 278.183 prohibits the investigation of existing rates in a surcharge application by providing that eligible environmental costs may be recovered by surcharge "[n]ot withstanding any other provision of this chapter." Such prohibition does not, standing alone, result in excessive rates or prevent the initiation of a separate investigation of existing rates.

KRS 278.183 authorizes the recovery by surcharge of only those eligible environmental costs not already included in existing rates. Thus, the legislature has established a supplementary rate-making scheme for the expedited recovery of limited costs that were not considered when a utility's existing rates were established. While fair, just and reasonable rates were established for LG&E in 1990 in Case No. 90-158, the surcharge now established allows recovery of only additional expenses and a return on additional capital expenditures not included in existing rates. Furthermore, relief is always available under KRS 278.260 for the investigation of existing rates to determine if they are excessive. There is no evidence in this case, however, to demonstrate that LG&E's existing rates are excessive.

Next, the AG argues that the Commission improperly defined LG&E's compliance plan to consist of five capital projects and new permit fees. According to the AG, these items are merely additions to LG&E's existing compliance plan and the April 6, 1995 Order should be amended to reflect this.

At the outset the Commission notes that the AG previously raised no objection to the contents of LG&E's compliance plan despite an adequate opportunity to do so prior to its approval by the April 6, 1995 Order. Further, the contents of a utility's environmental compliance plan define the parameters of the costs to be recovered by surcharge. Here there is no evidence or even an allegation that LG&E will recover by surcharge any costs not directly related to the projects in its compliance plan.

As the Commission discussed in approving an environmental surcharge for Kentucky Utilities Company, the projects included in a utility's environmental compliance plan under KRS 278.183 may well differ from those included in its federally mandated compliance plan under the Clean Air Act as amended.[2] These differences, however, do not redefine the compliance plan filed under KRS 278.183.

The AG also seeks rehearing on several issues pertaining to the alternative methodologies proposed for calculating LG&E's surcharge -- the incremental method and the "base current" method.

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[2] Case No. 93-465, Application of Kentucky Utilities Company to Assess a Surcharge Under KRS 278.183 to Recover Costs of Compliance with Environmental Requirements for Coal Combustion Wastes and By-Products, Order dated July 19, 1994, page 3.

Quoting the Commission's finding that "either approach is reasonable for determining those costs eligible for surcharge recovery,"[3] the AG requests clarification of whether the word "costs" refers to "costs that LG&E is trying to add or the level of the surcharge."[4] KRS 278.183 sets forth the precise definition of costs eligible for recovery by environmental surcharge. Further, since the statute limits the surcharge recovery to costs not already included in existing rates, the AG's petition does not explain how the costs to be "added" by LG&E could result in anything other than "the level of the surcharge."

The AG also argues that the two methods for calculating the surcharge will produce radically different results but cites no evidence to support this argument. In any event, the issue is moot because the Commission rejected using the "base current" method for LG&E due to the absence of necessary supporting accounting records. As the Commission stated in its April 6, 1995 Order, two environmental surcharges have been previously approved -- one calculated using the incremental method, the other using the "base current" method. The AG presents no evidence to demonstrate that either methodology will not produce reasonable results.

The AG characterizes the methodology used by the Commission to calculate LG&E's surcharge as being an attempt to reconcile the

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[3] Order dated April 6, 1995, p. 8.

[4] AG Petition for Rehearing, p. 5.

incremental and "base current" methods but which omits a necessary adjustment to reflect depreciation. Contrary to this assertion, the Commission did not modify LG&E's proposed incremental approach to recognize the retirement of environmental plant already included in existing rates. Rather, the Commission followed the dictates of KRS 278.183 by including in the surcharge only those costs not already included in existing rates. Since a portion of the costs LG&E sought to recover by surcharge are already in base rates, it would be unreasonable to allow a double recovery.

While the base current method does recognize changes in the depreciation level of environmental plant already included in existing rates, the incremental method does not. As noted above, the "base current" method was not suitable for use here due to the absence of detailed accounting records necessary to calculate not only changes in depreciation but other related expenses including insurance and property taxes.

The AG urges the Commission to correct its decision to not recognize the retirement due to depreciation of existing environmental assets. However, the retirement by depreciation referenced by the AG relates to environmental assets not included in LG&E's compliance plan as filed under KRS 278.183. Thus, any such retirement will have no impact on the calculation of the surcharge under the incremental approach adopted for LG&E. The AG's claim that the Commission ignored the level of environmental costs already in existing rates is belied by the explicit finding in the April 6, 1995 Order, page 16, that over $12 million in

environmental plant and $3 million in accumulated depreciation are to be deducted from LG&E's rate base to recognize costs already included in existing rates.

Finally, the AG's assertion that depreciation data on existing environmental assets are known and available has no relevancy to the incremental methodology adopted here. The AG's efforts appear to be an attempt to reargue the rejection of the "base current" methodology, despite the AG's inability to demonstrate that sufficient accounting records exist to properly use that method.

IT IS THEREFORE ORDERED that the applications for rehearing filed by LG&E and the AG be and they hereby are denied.

Done at Frankfort, Kentucky, this 12th day of May, 1995.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Executive Director