

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	)	
UTILITIES COMPANY FOR THE SIX-MONTH	)	CASE NO.
BILLING PERIODS ENDING JULY 31, 2003,	)	2006-00129
JANUARY 31, 2004, JANUARY 31, 2005,	)	
JULY 31, 2005, AND JANUARY 31, 2006 AND	)	
FOR THE TWO-YEAR BILLING PERIOD ENDING	)	
JULY 31, 2004	)	

O R D E R

On July 19, 1994, the Commission approved Kentucky Utilities Company's ("KU") environmental surcharge application and established a surcharge mechanism.<sup>1</sup> Pursuant to KRS 278.183(3), at 6-month intervals, the Commission must review the past operations of the environmental surcharge. After hearing, the Commission may, by temporary adjustment in the surcharge, disallow any surcharge amounts found not to be just and reasonable and reconcile past surcharges with actual costs recoverable pursuant to KRS 278.183(1). At 2-year intervals, the Commission must review and evaluate the past operations of the environmental surcharge. After hearing, the Commission must disallow improper expenses and, to the extent appropriate, incorporate surcharge amounts found just and reasonable into the existing base rates of the utility.

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<sup>1</sup> Case No. 1993-00465, The 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, final Order dated July 19, 1994.

The Commission has determined that it will be administratively efficient and reasonable to review the pending 6-month periods and the 2-year periods in the same case. Therefore, the Commission hereby initiates the 6-month reviews of the surcharge as billed from February 1, 2003 to July 31, 2003, from August 1, 2003 to January 31, 2004, from August 1, 2004 to January 31, 2005, from February 1, 2005 to July 31, 2005, and from August 1, 2005 to January 31, 2006 and the 2-year review of the surcharge as billed from August 1, 2002 to July 31, 2004.<sup>2</sup>

To facilitate this review, a procedural schedule is set forth in Appendix A, attached hereto and incorporated herein. In accordance with that schedule, KU is to file prepared direct testimony: (a) in support of the reasonableness of the application of its environmental surcharge mechanism during the time periods under review; and (b) on a proposal to roll-in its environmental surcharge into existing base rates. In addition, KU is to file its response to the information requested in Appendix B, attached hereto and incorporated herein. Since each of the periods under review in this proceeding may have resulted in over- or under-recoveries, the Commission will entertain proposals to adopt one adjustment factor to net all over- or under-recoveries.

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<sup>2</sup> Since KU's surcharge is billed on a two-month lag, the amounts billed from February 2003 through July 2003 are based on costs incurred from December 2002 through May 2003; August 2003 through January 2004 are based on costs incurred from June 2003 through November 2003; amounts billed from August 2004 through January 2005 are based on costs incurred from June 2004 through November 2004; February 2005 through July 2005 are based on costs incurred from December 2004 through May 2005; amounts billed from August 2005 through January 2006 are based on costs incurred from June 2005 through November 2005; and amounts billed from August 2002 through July 2004 are based on costs incurred from June 2002 through May 2004.

Since the approval of its original environmental compliance plan and surcharge mechanism, KU has sought and been granted three amendments to its original environmental compliance plan and surcharge mechanism.<sup>3</sup> In Case No. 2003-00068,<sup>4</sup> KU's surcharge mechanism was changed from the incremental approach to the base-current approach and a portion of the environmental surcharge was incorporated, or "rolled-in," to existing base rates. In Case No. 2003-00434,<sup>5</sup> the capital expenditures and operating expenses associated with the original environmental compliance plan were rolled-in to KU's base rates. After this last roll-in, the environmental surcharge provides recovery of the costs associated with the three amended environmental compliance plans. When determining its over- or under-recovery of the surcharge in this proceeding, KU should reflect the impacts of these prior cases, as applicable.

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<sup>3</sup> See Case No. 2000-00439, The Application of Kentucky Utilities Company for Approval of an Amended Compliance Plan for Purposes of Recovering the Costs of New and Additional Pollution Control Facilities and to Amend Its Environmental Surcharge Tariff, final Order dated April 18, 2001; Case No. 2002-00146, The Application of Kentucky Utilities Company for Approval of Its 2002 Compliance Plan for Recovery by Environmental Surcharge, final Order dated February 11, 2003; and 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 for Recovery by Environmental Surcharge, final Order dated June 20, 2005.

<sup>4</sup> Case No. 2003-00068, An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Utilities Company for the Six-Month Billing Periods Ending January 31, 2001, July 31, 2001, January 31, 2002, and January 31, 2003 and for the Two-Year Billing Periods Ending July 31, 2000 and July 31, 2002, final Order dated October 17, 2003.

<sup>5</sup> Case No. 2003-00434, An Adjustment of the Electric Rates, Terms, and Conditions of Kentucky Utilities Company, final Order dated June 30, 2004.

IT IS THEREFORE ORDERED that:

1. The procedural schedule set forth in Appendix A, attached hereto and incorporated herein, shall be followed in this proceeding.

2. KU shall appear at the Commission's offices on the date set forth in Appendix A, to submit itself to examination on the application of its environmental surcharge as billed to consumers from (a) February 1, 2003 through July 31, 2003; (b) August 1, 2003 through January 31, 2004; (c) August 1, 2004 through January 31, 2005; (d) February 1, 2005 through July 31, 2005; (e) August 1, 2005 through January 31, 2006; and, (f) August 1, 2002 through July 31, 2004. At the public hearing there shall be no opening statements or summaries of testimony.

3. KU shall give notice of the hearing in accordance with the provisions of 807 KAR 5:011, Section 8(5). At the time publication is requested, KU shall forward a duplicate of the notice and request to the Commission.

4. KU shall, by the date set forth in Appendix A, file the information requested in Appendix B, attached hereto and incorporated herein, along with its prepared direct testimony in support of the reasonableness of the application of its environmental surcharge mechanism during the six periods under review.

5. Any party filing testimony shall file an original and 9 copies.

6. All requests for information and responses thereto shall be appropriately indexed, and an original and 6 copies shall be filed with the Commission, with copies to all parties of record. Any request for information from the Commission Staff shall be responded to as if set forth in a Commission order. All responses shall include the

name of the witness who will be responsible for responding to questions related to the information provided.

7. Within 7 days of the Commission granting intervention to a party, KU shall provide the party with a copy of its monthly environmental surcharge reports as filed with the Commission for each review period.

8. KU's monthly environmental surcharge reports and supporting data for the review periods shall be incorporated by reference into the record of this case.

9. The case records of Case Nos. 1993-00465, 2000-00439, 2002-00146, 2003-00068, 2003-00434, and 2004-00426 shall be incorporated by reference into the record of this case.

10. Any objections or motions relating to discovery or procedural dates shall be filed upon 4 business days' notice or shall include an explanation why such notice was not possible.

Done at Frankfort, Kentucky, this 25<sup>th</sup> day of April, 2006.

By the Commission

ATTEST:



Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE  
COMMISSION IN CASE NO. 2006-00129 DATED April 25, 2006

- KU shall file its prepared direct testimony and responses to the information requested in Appendix B no later than ..... 06/05/06
- An informal technical conference is to begin at 1:30 p.m., Eastern Daylight Time, in Conference Room No. 1 of the Commission's offices at 211 Sower Boulevard, Frankfort, Kentucky for the discussion of issues ..... 06/13/06
- All additional requests for information to KU shall be filed no later than ..... 06/27/06
- KU shall file responses to additional requests for information no later than ..... 07/12/06
- Intervenor testimony, if any, in verified prepared form shall be filed no later than ..... 07/21/06
- All requests for information to Intervenors shall be filed no later than ..... 08/04/06
- Intervenors shall file responses to requests for information no later than ..... 08/18/06
- Last day for KU to publish notice of hearing date ..... To be scheduled
- Public Hearing is to begin at 9:00 a.m., Eastern Daylight Time, in Hearing Room 1 of the Commission's offices at 211 Sower Boulevard, Frankfort, Kentucky, for the purpose of cross-examination of witnesses of KU and Intervenors ..... To be scheduled
- Briefs, if any, shall be filed by ..... To be scheduled

## APPENDIX B

### APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2006-00129 DATED April 25, 2006

#### FIRST DATA REQUEST OF COMMISSION STAFF TO KENTUCKY UTILITIES COMPANY

##### For Each of the Six Periods Under Review

1. Concerning the rate of return on the original environmental compliance plan ("1994 Plan") and the three amendments to the environmental compliance plan ("Post-1994 Plans"), provide the following information for each of the billing periods under review:

a. For the 1994 Plan, calculate any true-up adjustment needed to recognize changes in the weighted average cost of KU's pollution control debt during the applicable months of each review period. Include all assumptions and other supporting documentation used to make this calculation. Any true-up adjustment is to be included in the determination of the over- or under-recovery of the surcharge for the corresponding billing period under review.

b. For the Post-1994 Plans, calculate any true-up adjustment needed to recognize changes in KU's cost of debt, preferred stock, accounts receivable financing (if applicable), or changes in KU's jurisdictional capital structure. Include all assumptions and other supporting documentation used to make this calculation. Any true-up adjustment is to be included in the determination of the over- or under-recovery of the surcharge for the corresponding billing period under review.

2. Consistent with the Commission's Order in Case No. 2004-00426, for each applicable billing period under review, calculate the effect of removing from the reported inventory of emission allowances included the environmental compliance rate base the sulfur dioxide ("SO<sub>2</sub>") emission allowances assigned or allocated to gas-fired generating units. Include all assumptions and other supporting documentation used to make this calculation. In addition, include this calculation as an adjustment to the over- or under-recovery of the surcharge determined for the corresponding billing period under review.

3. Prepare a summary schedule showing the calculation of Total E(m), Net Retail E(m), and the surcharge factor for the expense months covered by the applicable billing period. Include the expense months for the two expense months subsequent to the billing period in order to show the over- and under-recovery adjustments for the months included for the billing period under review. The summary schedule is to incorporate all corrections and revisions to the monthly surcharge filings KU has submitted during the billing periods under review. Include a calculation of any additional over- or under-recovery amount KU believes needs to be recognized for each 6-month review or the 2-year review. Include all supporting calculations and documentation for any such additional over- or under-recovery.

4. Provide the calculations, assumptions, workpapers, and other supporting documents used to determine the amounts KU has reported during each billing period under review for Pollution Control Deferred Income Taxes.

5. Provide the percentage of KU's long-term debt that has a variable interest rate as of the last expense month in the applicable billing period under review.



Billing Period from February 1, 2003 through July 31, 2003

6. Refer to ES Form 2.10, Plant, CWIP & Depreciation Expense – 1994 Plan, for the April and May 2003 expense months. Explain why the amount shown in the “Eligible Accumulated Depreciation” column, the “Less Eliminations – Final Settlement 93-465” line, was “overstated” for these expense months. KU’s monthly surcharge filing in July 2003 provided corrections for the amounts, but no explanation as to why this error occurred.

7. Refer to ES Form 2.50, Pollution Control – Operations & Maintenance Expenses, for the March through May 2003 expense months. Explain why the operations and maintenance (“O&M”) expenses for these expense months were higher than the first three expense months in this billing period. The level of detail for this response should go to the expense account number and by generating station.

Billing Period from August 1, 2003 through January 31, 2004

8. Refer to ES Form 2.31, Inventory of Emission Allowances – Current Vintage Year, for the July 2003 expense month.

a. Explain the reason(s) for the addition of 238 allowances to the inventory and how the value of \$38,390 was determined.

b. Explain the reason(s) for the reduction of 507 allowances from the beginning inventory balance. The surcharge monthly report indicates this reduction was reversed in the September expense month.

9. Refer to ES Form 2.50, Pollution Control – Operations & Maintenance Expenses, for the June, August, and October 2003 expense months. Explain why the O&M expenses for these expense months were higher than the remaining three

expense months in the billing period. The level of detail for this response should go to the expense account number and by generating station.

Billing Period from August 1, 2002 through July 31, 2004

10. Refer to ES Form 2.50, Pollution Control – Operations & Maintenance Expenses, for the December 2003 and March through May 2004 expense months. Explain why the O&M expenses for these months were higher than the remaining two expense months in the billing period. The level of detail for this response should go to the expense account number and by generating station.

11. In Case No. 2000-00439, the Commission ordered that KU's rate of return on common equity for the Post-1994 Plan projects included in its environmental surcharge would be the same rate of return on common equity incorporated in KU's Earnings Sharing Mechanism ("ESM"). The Commission further ordered that this rate of return on common equity would remain unchanged unless the rate in the ESM was changed or discontinued. In Case No. 2003-00434, KU's ESM was discontinued and the rate of return on common equity for environmental surcharge purposes was set at 11.00 percent. In Case No. 2004-00426, the Commission established the rate of return on common equity for the environmental surcharge at 10.5 percent.

a. Does KU believe that the 10.5 percent rate of return on common equity for the environmental surcharge is reasonable? Explain the response, and include any analyses or evaluations supporting its conclusions.

b. If no to part (a), what rate of return on common equity does KU propose for its environmental surcharge? Provide a detailed analysis and testimony supporting KU's position.

12. KRS 278.183(3) provides that during the 2-year review, the Commission shall, to the extent appropriate, incorporate surcharge amounts found just and reasonable into the existing base rates of the utility.

a. Provide the surcharge amount that KU believes should be incorporated into its existing base rates. Include all supporting calculations, workpapers, and assumptions.

b. The surcharge factor reflects a percentage of revenue approach, rather than a per kWh approach. Taking this into consideration, explain how the surcharge amount should be incorporated into KU's base rates. Include any analysis that KU believes supports its position.

c. Provide the Base Period Jurisdictional Environmental Surcharge Factor ("BESF") that reflects all environmental surcharge amounts previously incorporated into existing base rates and the amount determined in part (a). Include all supporting calculations, workpapers, and assumptions.

d. Does KU believe that there will need to be modifications to either the surcharge mechanism or the monthly surcharge reports, other than a revision to BESF, as a result of incorporating additional environmental surcharge amounts into KU's existing base rates? If yes, provide a detailed explanation of the modifications and provide updated monthly surcharge reports.

13. In order to reflect the impact of the Partial Settlement Agreement, Stipulation and Recommendation approved in the June 30, 2004 Order in Case No. 2003-00434, KU modified the Post-1994 Plan environmental compliance rate base to recognize a SO<sub>2</sub> emission allowance inventory "baseline" when determining the SO<sub>2</sub>

emission allowance inventory balance included in the rate base. This incremental approach allowed for the recognition of a portion of the SO<sub>2</sub> emission allowance inventory balance being incorporated into existing base rates. Would KU agree, that in conjunction with any “roll-in” of the surcharge approved in this case, that this emission allowance inventory “baseline” calculation should be discontinued and the balance of SO<sub>2</sub> emission allowance inventory recovered as part of existing base rates should be reflected in the BESF calculation? Explain the response.

Billing Period from August 1, 2004 through January 31, 2005

No questions specifically related to this billing period.

Billing Period from February 1, 2005 through July 31, 2005

14. Refer to ES Form 2.40, O&M Expenses and Determination of Cash Working Capital Allowance, and ES Form 2.50, Pollution Control – Operations & Maintenance Expenses, for the December 2004, February 2005, and March 2005 expense months.

a. For the December 2004 expense month, KU reported \$550,307 in nitrogen oxide (“NO<sub>x</sub>”) O&M expenses. Explain why the NO<sub>x</sub> O&M expenses reported in December 2004 were significantly higher than the amounts reported in any of the subsequent months in the billing period.

b. Reconcile the \$550,307 shown as “2<sup>nd</sup> Previous Month” on ES Form 2.40 for the February 2005 expense month with the amounts shown as “11<sup>th</sup> Previous Month” through “3<sup>rd</sup> Previous Month” on ES Form 2.40 for the March 2005 expense month. Include an explanation of how the lump sum amount was assigned or allocated to the various months.

c. For the December 2004 expense month, KU showed that approximately \$205 million in construction work in progress related to its Selective Catalytic Reduction (“SCR”) equipment was reclassified as eligible plant in service. Given this information, and the Commission’s instructions in Case No. 2000-00439 concerning NOx O&M expenses, explain how KU could claim any NOx O&M expenses for the 4<sup>th</sup> through the 11<sup>th</sup> previous month, as shown on ES Form 2.40 for the March 2005 expense month.

Billing Period from August 1, 2005 through January 31, 2006

15. Refer to ES Form 2.50, Pollution Control – Operations & Maintenance Expenses, for the October and November 2005 expense months. Explain why the O&M expenses reported in these months are lower than the four previous expense months.

16. Refer to ES Form 2.11, Plant, CWIP & Depreciation Expense – Post-1994 Plan, for the November 2005 expense month. For each project shown on this schedule that is not considered completed, provide a description of the status of the project as of the end of the November 2005 expense month.

17. In Case No. 2000-00439, the Commission ordered that KU’s cost of debt and preferred stock would be reviewed and re-established during the 6-month review case. Provide the following information as of November 30, 2005:

a. The outstanding balances for long-term debt, short-term debt, preferred stock, and common equity. Provide this information on total company and Kentucky jurisdictional bases.

b. The blended interest rates for long-term debt, short-term debt, and preferred stock. Include all supporting calculations showing how these blended interest

rates were determined. If applicable, provide the blended interest rates on total company and Kentucky jurisdictional bases.

c. KU's calculation of its weighted average cost of capital for environmental surcharge purposes.

18. Provide the following information concerning KU's SO<sub>2</sub> emission allowance inventory:

a. The number of emission allowances in the ending inventory balance as of December 31, 2005. The ending balance should reflect all available past vintage years of emission allowances through the 2005 vintage year. Also show the portion of the ending balance represented by allowances received from Owensboro Municipal Utilities ("OMU").

b. For each year in the period 2006 through 2016:

(1) Indicate the number of emission allowances allocated or expected to be allocated by the Environmental Protection Agency for KU's generating units.

(2) Indicate the number of emission allowances estimated to be received from OMU.

(3) Indicate the number of emission allowances KU estimates it will utilize in conjunction with the operation of its generating units. Reflect the changes resulting from the adoption of the Clean Air Interstate Rule.

(4) If available, indicate any other estimated additions or withdrawals of emission allowances from KU's emission allowance inventory. Include a description of the type of addition or withdrawal.

19. Through the end of 2016, does KU plan on achieving SO<sub>2</sub> emission limit compliance for its generating units only through the operation of its currently in service emission control equipment, emission control equipment certificated and included in its environmental compliance plans, and the consumption of emission allowances? If no, describe KU's current plans for SO<sub>2</sub> emission limit compliance at its generating units through the end of 2016.

20. While reviewing the monthly surcharge filings corresponding to the billing periods included in the 6-month and 2-year reviews, it has been observed that KU has had to file at least one revision or correction to previously filed monthly surcharge reports within each 6-month block of time. These revisions or corrections dealt with errors or inadvertent omissions KU discovered after the filing of the applicable monthly surcharge report.

a. Describe the processes employed by KU to collect and assemble the information submitted in the monthly surcharge filings.

b. Describe the internal controls employed by KU to ensure that the data provided in the processes described in part (a) are accurate and current.