

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN EXAMINATION BY THE PUBLIC SERVICE	)	
COMMISSION OF THE ENVIRONMENTAL	)	CASE NO.
SURCHARGE MECHANISM OF KENTUCKY	)	2009-00310
UTILITIES COMPANY FOR THE TWO-YEAR	)	
BILLING PERIOD ENDING APRIL 30, 2009	)	

O R D E R

On August 18, 2009, the Commission initiated a two-year review of Kentucky Utilities Company's ("KU") environmental surcharge as billed to customers for the two-year period May 1, 2007 to April 30, 2009.<sup>1</sup> 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 not just and reasonable; and reconcile past surcharge collections with actual costs recoverable. At two-year intervals, the Commission must review and evaluate the past operations of the environmental surcharge, disallow improper expenses and, to the extent appropriate, incorporate surcharge amounts found just and reasonable into the existing base rates of the utility.

The Commission issued a procedural schedule on August 18, 2009 that provided for discovery, the filing of prepared testimony, an informal conference, and a public hearing. KU filed prepared direct testimony and responded to requests for

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<sup>1</sup> KU's surcharge is billed on a two-month lag. Thus, surcharge billings for May 2007 through April 2009 are based on costs incurred from March 2007 through February 2009.

information. On September 29, 2009, KU and Commission Staff (“Staff”) participated in an informal conference to discuss the issues in the case. During the conference, Staff requested further information, which KU submitted on October 9, 2009. KU requested that this case be submitted for a decision based on the existing record without a public hearing. Based on the absence of intervenors and finding good cause, the Commission will grant KU’s request and decide this case based on the evidence of record without a hearing.

### SURCHARGE ADJUSTMENT

The August 18, 2009 Order initiating this case indicated that, since the period under review in this proceeding may have resulted in over- or under-recoveries, the Commission would entertain proposals to adopt one adjustment factor to net all over- or under-recoveries. KU determined that it had a net under-recovery of its environmental costs for the period of \$3,821,966.<sup>2</sup> KU proposed that the net under-recovery be collected from customers over a six-month period by increasing the total jurisdictional environmental surcharge revenue requirement by \$636,994 per month for the first four months and \$636,995 for the last two months, beginning in the second full billing month following the Commission’s decision in this proceeding.<sup>3</sup>

The Commission has reviewed and finds reasonable KU’s calculation of a net under-recovery of \$3,821,966 for the billing period covered in this proceeding. The Commission also finds reasonable KU’s proposal to increase the total jurisdictional

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<sup>2</sup> Conroy Revised Direct Testimony at 5.

<sup>3</sup> Id. at 9.

environmental surcharge revenue requirement in each of the first four billing months by \$636,994 per month and by \$636,995 per month for the next two months, beginning in the second full billing month following the Commission's decision in this proceeding. The Commission has estimated that a customer using 1,000 kWh would see an increase of approximately \$0.48 per month associated with the recovery of the net under-recovery during the six-month period.

#### SURCHARGE ROLL-IN

KU proposed that it is appropriate in this case to incorporate surcharge amounts found just and reasonable for the two-year billing period into its existing base rates. KU recommended that this "roll-in" be in the amount of \$86,667,849.<sup>4</sup> KU determined the roll-in amount using the base-current methodology, consistent with current practice and as previously approved by the Commission. The Commission has reviewed and finds it reasonable that \$86,667,849 from the surcharge should be rolled into KU's existing base rates.

#### ALLOCATION OF ROLL-IN

KU proposed to follow the methodology approved by the Commission in Case No. 2007-00379,<sup>5</sup> which allocates the roll-in amount to the customer classes on the basis of base-rate revenues. KU also proposed to follow the approach approved in Case No. 2007-00379 to assign the amount of the roll-in to the energy component of

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<sup>4</sup> Id.

<sup>5</sup> Case No. 2007-00379, An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Kentucky Utilities Company for the Six-Month Billing Period Ending October 31, 2006, and for the Two-Year Billing Period Ending April 30, 2007 (Ky. PSC, March 28, 2008).

rate schedules with no separate demand charges and to the demand component for all rates that include a separately metered and billed demand component. It proposed that the roll-in for lighting rates be assigned on a per-light basis.<sup>6</sup>

The Commission has reviewed and finds reasonable KU's proposal to allocate the roll-in of \$86,667,849 on the basis of base-rate revenues. This approach is consistent with previous surcharge review cases where there has been a roll-in of the surcharge into existing base rates. The Commission also finds that KU's proposal concerning the assignment of the roll-in amounts to either the energy charge, demand charge, or on a per-light basis, is reasonable and should be approved.

#### RATE OF RETURN

KU provided the outstanding balances for its long-term debt, short-term debt, and common equity as of February 28, 2009, the last billing month of the review period. It also provided the blended interest rates for the long-term debt and short-term debt as of February 28, 2009.<sup>7</sup> Using this information, along with the currently approved 10.63 percent return on equity,<sup>8</sup> KU calculated an overall rate of return on capital, before

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<sup>6</sup> Response to Commission Staff's First Data Request dated September 15, 2009, Item 6.

<sup>7</sup> Id., Item 7.

<sup>8</sup> Case No. 2008-00251, Application of Kentucky Utilities Company for an Adjustment of Electric Base Rates (Ky. PSC Feb. 5, 2009).

income tax gross-up, of 7.76 percent.<sup>9</sup> KU also provided the overall rate of return on capital reflecting the tax gross-up approach approved in Case No. 2004-00426.<sup>10</sup>

The Commission has reviewed KU's determination of the overall rate of return on capital and finds the 7.76 percent to be reasonable. The Commission has also reviewed the determination of the tax gross-up factor and finds that it is consistent with the approach approved in Case No. 2004-00426. Therefore, the Commission finds that the weighted average cost of capital of 7.76 percent and the income tax gross-up factor of 0.58, which produces an overall grossed-up return of 11.0 percent, should be used in all KU monthly environmental surcharge filings subsequent to the date of this Order.

#### MODIFICATION OF ENVIRONMENTAL COST RECOVERY MECHANISM

KU proposed to modify the calculation of the monthly billing factor from a percentage method to a revenue requirement method. This modification will require revisions to the monthly ES Forms 1.00, 1.10 and 2.00. KU states that recent enhancements in reporting capabilities allow it to determine the actual environmental costs recovered in base rates prior to filing its monthly environmental surcharge report. The current methodology expresses the components of the monthly billing factor as a percentage of 12-month historical revenues, which contributes to significant fluctuations in over- and under-recoveries of environmental surcharge revenues. KU states that the

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<sup>9</sup> Id.

<sup>10</sup> 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 and Response to the Commission Staff's First Data Request dated August 18, 2009, Item 12. In the response, KU determined that the income tax gross-up factor was 0.58 which would produce a tax grossed-up weighted average cost of capital of 11.00 percent.

proposed modification will eliminate the use of the percentage to calculate the monthly billing factor, thereby providing a more accurate monthly environmental revenue requirement. KU stated that the monthly true-up adjustment will no longer be necessary and proposed that it be eliminated as a result of the aforementioned revisions. This proposed revision does not change the current methodology in determining the monthly environmental revenue requirement, and there will be no change in the total revenues that KU is allowed to collect through its environmental surcharge. The Commission has reviewed the proposed modifications to the monthly environmental surcharge billing methodology and finds they should be adopted and approved for use in KU's monthly environmental surcharge filings.

IT IS THEREFORE ORDERED that:

1. KU's request to submit this case for a decision on the existing evidence of record without a hearing is granted.
2. KU shall include a \$636,994 monthly increase in its jurisdictional environmental revenue requirement determined in the first four months and a \$636,995 increase in the next two months, beginning in the second full billing month following the month in which the Commission issues its Final Order in this proceeding.
3. KU shall roll into its existing base rates \$86,667,849 in environmental surcharge amounts found to be just and reasonable herein. The roll-in shall be allocated to the customer classes on the basis of base rate revenues. The assignment of the roll-in amount to base rate components shall be as described herein.

4. KU shall use an overall rate of return on capital of 7.76 percent, a tax gross-up factor of 0.58, and an overall grossed-up return of 11.0 percent in all monthly environmental surcharge filings subsequent to the date of this Order.

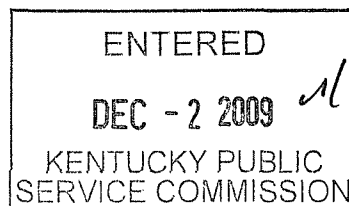
5. KU shall make the proposed modifications described herein to the calculation of the monthly environmental surcharge billing factor beginning with the second full billing month following the month in which the Commission issues its Final Order in this proceeding.

6. KU's proposed modifications to ES Forms 1.00, 1.10 and 2.00 are approved and shall be included with KU's first monthly surcharge filing submitted per Ordering Paragraph 5.

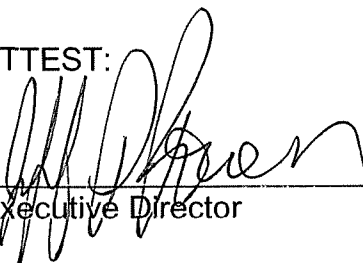
7. KU shall file revised tariffs reflecting the changes to its base rates as a result of the roll-in of environmental surcharge amounts described herein; the same type of supporting documentation it filed in Case No. 2007-00379; and a red-lined version of its tariffs, all within 20 days following the date of this Order.

8. KU shall file revised environmental surcharge tariffs reflecting the changes described herein within 20 days following the date of this Order.

By the Commission



ATTEST:

  
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Executive Director

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