

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) CASE NO. 2012-00207
UTILITIES COMPANY FOR THE SIX-MONTH)
BILLING PERIODS ENDING OCTOBER 31, 2011)
AND APRIL 30, 2012)

ORDER

On June 13, 2012, the Commission initiated a six-month review of Kentucky Utilities Company's ("KU") environmental surcharge as billed to customers for the six-month periods beginning May 1, 2011 through October 31, 2011 and November 1, 2011 to April 30, 2012.¹ Pursuant to KRS 278.183(3), the Commission must review, at six-month intervals, the past operations of a utility's environmental surcharge. 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 pursuant to KRS 278.183(1).

The Commission issued a procedural schedule that provided for discovery, the filing of prepared testimony, an informal technical conference, and a public hearing. KU filed prepared direct testimony and responded to requests for information. On July 12, 2012, KU and Commission Staff participated in an informal

¹ KU's environmental surcharge is billed on a two-month lag. Thus, surcharge billings for May 2011 through October 2011 are based on costs incurred from March 2011 through August 2011; and the surcharge billings for November 2011 through April 2012 are based on costs incurred from September 2011 through February 2012.

technical conference to discuss the issues in the case. On August 27, 2012, KU requested that the Commission take this case under submission for decision and issue an Order by September 30, 2012. 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 June 13, 2012 Order initiating this case indicated that, since over- or under-recoveries of allowable environmental compliance costs may have occurred during the period under review, the Commission would entertain proposals to adopt one adjustment factor to net all over- or under-recoveries. KU determined that it had a net over-recovery of environmental costs for the billing periods ending October 31, 2011 and April 30, 2012 of \$2,998,160.² It proposed that the net over-recovery be refunded to customers over six months following the Commission's Order in this proceeding. KU recommended that the Commission approve a decrease to the jurisdictional environmental surcharge revenue requirement of \$499,693 for four months and \$499,694 for two months, beginning in the second full billing month following the Commission's Order in this proceeding.³

The Commission has reviewed and finds reasonable KU's calculation of a net over-recovery of \$2,998,160 for the billing periods covered in this proceeding. The Commission also finds reasonable KU's proposal to decrease the total jurisdictional environmental surcharge revenue requirement by \$499,693 for four months and

² Direct Testimony of Robert M. Conroy, p.5.

³ *Id.* at 7.

\$499,694 for two months, beginning in the second full billing month following the date of this Order. KU stated that the actual average residential customer's usage for the 12-months ending March 31, 2012 is 1,179 kWh per month.⁴ KU calculates that for a residential customer using 1,179 kWh per month, the impact of its proposed adjusted environmental cost recovery billing factor would be a decrease of approximately \$1.05 per month, using rates and adjustment clause factors in effect for the April 2012 billing month.⁵

RATE OF RETURN

KU provided the outstanding balances for its long-term debt, short-term debt, and common equity as of February 29, 2012, 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 February 29, 2012.⁷ Using this information, along with the currently approved 10.63 percent return on equity,⁸ KU calculated an overall rate of return on capital, before income tax gross-up, of 7.41 percent for its 2005, 2006, and 2009 Environmental

⁴ KU's response to Commission Staff's questions raised at the July 12, 2012 Informal Technical Conference, Item 1.

⁵ *Id.*

⁶ KU's response to Commission Staff's First Request for Information, Item 5.a.

⁷ *Id.* at Item 5.b.

⁸ Case No. 2009-00548, Application of Kentucky Utilities Company for an Adjustment of Base Rates (Ky. PSC July 30, 2010).

Compliance Plans (“Pre-2011 Plans”).⁹ KU also provided the overall rate of return on capital reflecting the tax gross-up approach approved in Case No. 2004-00426.¹⁰

Pursuant to the Settlement Agreement approved in Case 2011-00161,¹¹ KU used a 10.1 percent return on equity along with the February 29, 2012 outstanding balances for its long-term debt, short-term debt, and common equity and blended interest rate information to calculate an overall rate of return on capital, before income tax gross-up, of 7.13 percent for its 2011 Environmental Compliance Plan (“2011 Plan”). KU also provided the overall rate of return on capital reflecting the tax gross-up approach approved in Case No. 2004-00426.¹²

The Commission has reviewed KU’s calculation of the overall rate of return on capital and finds that its use of 7.41 percent is reasonable for the Pre-2011 Plans and should be approved. The Commission further finds that KU’s use of 7.13 percent is reasonable for its 2011 Plan and should be approved. The Commission has also reviewed KU’s calculation 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

⁹ KU’s response to Commission Staff’s First Request for Information, Item 5.

¹⁰ 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 and Recovery by Environmental Surcharge (Ky. PSC June 20, 2005); and KU’s response to Commission Staff’s First Request for Information, Item 5.c. In the response, KU determined that the income tax gross-up factor was 0.64, which would produce a tax grossed-up weighted average cost of capital of 10.58 percent.

¹¹ Case No. 2011-00161, Application of Kentucky Utilities Company for Certificates of Public Convenience and Necessity and Approval of Its 2011 Compliance Plan for Recovery by Environmental Surcharge (Ky. PSC Dec. 15, 2011).

¹² Case No. 2004-00426, Kentucky Utilities Company (Ky. PSC June 20, 2005); and KU’s response to Commission Staff’s First Request for Information, Item 5.c. In the response, KU determined that the income tax gross-up factor was 0.64, which would produce a tax grossed-up weighted average cost of capital of 10.14 percent.

the weighted average cost of capital for KU's Pre-2011 Plans of 7.41 percent and the income tax gross-up factor of 0.64 should be used in all KU monthly environmental surcharge filings beginning in the second full billing month following the date of this Order. The Commission also finds that the weighted average cost of capital for KU's 2011 Plan of 7.13 percent and the income tax gross-up factor of 0.64 should be used in all of KU's monthly environmental surcharge filings beginning in the second full month following the date of this Order.

IT IS THEREFORE ORDERED that:

1. KU's request that the Commission take this case under submission for decision is granted.

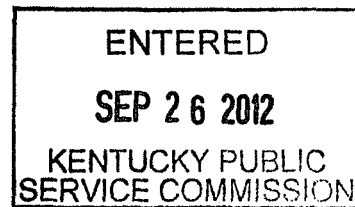
2. The amounts billed to customers by KU through its environmental surcharge for the periods from May 1, 2011 through October 31, 2011 and November 1, 2011 to April 30, 2012 are approved.

3. In the second full billing month following the date of this Order, KU shall decrease its jurisdictional environmental revenue requirement by \$499,693 per month for the first four months and thereafter shall decrease its jurisdictional environmental revenue requirement by \$499,694 for the following two months.

4. Beginning in the second full billing month following the date of this Order, for its Pre-2011 Plans, KU shall use an overall rate of return on capital of 7.41 percent, a tax gross-up factor of 0.64, a return on equity rate of 10.63 percent, and an overall grossed-up return of 10.58 percent in all future monthly environmental surcharge filings unless directed otherwise by the Commission.

5. Beginning in the second full billing month following the date of this Order, for its 2011 Plan, KU shall use an overall rate of return on capital of 7.13 percent, a tax gross-up factor of 0.64, a return on equity rate of 10.1 percent, and an overall grossed-up return of 10.14 percent in all future monthly environmental surcharge filings unless directed otherwise by the Commission.

By the Commission



ATTEST:


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