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 LOUISVILLE GAS AND ELECTRIC COMPANY FOR THE TWO-YEAR BILLING PERIOD ENDING APRIL 30, 2015	)))))	CASE NO. 2015-00222

O R D E R

On July 10, 2015, the Commission initiated a two-year review of Louisville Gas and Electric Company's ("LG&E") environmental surcharge as billed to customers for the two-year period May 1, 2013, to April 30, 2015.[1] 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. For purposes of this review, the Commission has examined LG&E's monthly environmental surcharges for the six-month billing period ending April 30, 2015, which is the last six-month billing period of the two-year billing period ending April 30, 2015, and for the two-year billing period ending April 30, 2015. The three previous six-month

[1] LG&E's surcharge is billed on a two-month lag. Thus, surcharge billings for May 2013 through April 2015 are based on costs incurred from March 2013 through February 2015.

billing periods of this two-year period were reviewed in Case Nos. 2013-00437 and 2015-00021.[2]

The Commission issued a procedural schedule on July 10, 2015, that provided for discovery, the filing of prepared testimony, and an informal conference. LG&E filed a motion for extension of time to file testimony and data responses on July 30, 2015, which was granted by an Order issued on August 5, 2015, along with a modified procedural schedule. LG&E filed prepared direct testimony and responded to two requests for information. On August 27, 2015, and November 30, 2015, LG&E and Commission Staff ("Staff") participated in informal conferences to discuss the issues in the case. There are no intervenors in this proceeding. LG&E requested that this case be submitted for a decision based on the existing record without a public hearing. Finding good cause, the Commission will grant LG&E's request and decide this case based on the evidence of record without a hearing.

SURCHARGE ADJUSTMENT

The July 10, 2015 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. LG&E determined that it had a cumulative under-recovery of its environmental costs for the period of $1,959,324.[3] LG&E recommended that the Commission approve an increase to the jurisdictional environmental surcharge revenue

[2] Case No. 2013-00437, *An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Louisville Gas & Electric Company for the Six-Month Billing Period Ending October 31, 2013* (Ky. PSC July 11, 2014); and Case No. 2015-00021, *An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Louisville Gas & Electric Company for the Six-Month Billing Period Ending April 30, 2014 and October 31, 2014* (Ky. PSC June 12, 2015).

[3] Direct Testimony of Robert M. Conroy ("Conroy Testimony") at 9.

requirement of $653,108 for three months, beginning in the second full billing month following the Commission's Final Order in this proceeding.[4]

The Commission has reviewed and finds reasonable LG&E's calculation of a net under-recovery of $1,959,324 for the billing period covered in this proceeding. The Commission also finds reasonable LG&E's proposal to increase the total jurisdictional environmental surcharge revenue requirement for three months by $653,108, beginning in the second full billing month following the Commission's decision in this proceeding. The increase in jurisdictional environmental surcharge revenue requirement would increase LG&E's environmental cost recovery billing factor by approximately 0.77 percent per month for three months.[5] LG&E stated that the actual average residential customer's usage for the 12-month period ending May 31, 2015, is 973 kWh per month.[6] LG&E calculates that, for a residential customer using 973 kWh per month, the impact of its proposed increase in environmental cost recovery billing factor would be an increase of approximately $0.74 each month, using rates and adjustment clause factors in effect for the July 2015 billing month.[7]

SURCHARGE ROLL-IN

LG&E proposed that it was appropriate in this case to incorporate surcharge amounts found just and reasonable for the two-year billing period into its existing base rates. LG&E recommended that this incremental "roll-in" be in the amount of

[4] *Id.* at 11.

[5] *Id.*

[6] LG&E's response to Commission Staff's First Request for Information ("Staff's First Request"), Item 7.

[7] *Id.*

$59,779,640.[8] LG&E determined the roll-in amount using the base-current methodology, consistent with current practice and as previously approved by the Commission. The incremental roll-in amount of $59,779,640 was determined using the environmental surcharge rate base as of February 28, 2015, and environmental surcharge operating expenses for the 12-month period ending February 28, 2015. With the incremental roll-in of $59,779,640, the total amount of environmental surcharge revenues that will be included in base rates will be $73,663,008. The Commission has reviewed and finds it reasonable that $59,779,640 from the surcharge should be rolled into LG&E's existing base rates incrementally, resulting in total environmental surcharge revenues in base rates of $73,663,008.

ALLOCATION OF ROLL-IN

LG&E proposed to follow the methodology used in the previous two-year review and approved by the Commission in Case No. 2011-00232[9] for the base rate roll-in. That Order authorized the use of the methodology previously approved in the Settlement Agreement in Case No. 2011-00162.[10] Per the Settlement Agreement, LG&E's rate classes will be divided into two groups: Group 1, as identified in Section 5.03 of the Settlement Agreement;[11] and Group 2, as identified in Section 5.04 of the

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[8] Revised Direct Testimony of Robert M. Conroy at 11.

[9] Case No. 2011-00232, *An Examination by the Public Service Commission of the Environmental Surcharge Mechanism of Louisville Gas & Electric Company for the Two-Year Billing Period Ending April 30, 2011* (Ky. PSC Feb. 29, 2012).

[10] Case No. 2011-00162, *Application of Louisville Gas and Electric 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).

[11] For LG&E, Group 1 would include the following rate classes: Residential Service, Volunteer Fire Department Service, Lighting Service, Restricted Lighting Service, Lighting Energy Service, Traffic Energy Service, Dark Sky Friendly, Low Emissions Vehicle Service, and Residential Responsive Pricing.

Settlement Agreement.[12] The $59,779,640 total roll-in is allocated between the two groups based on the percentage of each group's total revenue, excluding base environmental surcharge revenue, to LG&E's total revenue, excluding base environmental surcharge revenue. The rolled-in amounts for Group 1 also use total billed revenues excluding base environmental surcharge revenues to allocate costs to base rates between the rate classes in Group 1. For Group 2 rate classes, the roll-in will be allocated based on non-fuel revenues only for each Group 2 rate class, rather than total revenues excluding base environmental surcharge revenues, which has been the allocation methodology previously utilized for all rate classes, including what are now Group 2 rate classes. The Commission has reviewed and found reasonable LG&E's proposal to allocate the roll-in of $59,779,640 pursuant to the terms of the Settlement Agreement in Case No. 2011-00162. In accordance with the terms of the Settlement Agreement, LG&E shall use the revenue allocation methodology as described above unless directed to do otherwise by the Commission in the future.

The Settlement Agreement also stipulates that LG&E shall address the impact of the change in revenue allocation in its next two two-year environmental surcharge reviews or compliance plan proceedings, and if appropriate, offer recommendations after consulting with specific intervenors that are parties to the Settlement Agreement. The current proceeding is the second of the two-year environmental surcharge review cases to address the use of Group 1 and Group 2 billing factors. LG&E recommended that no changes be made to the allocation methodology because the results of the

[12] For LG&E, Group 2 would include the following rate classes: General Service, Power Service, Industrial Time-of-Day Secondary Service, Commercial Time-of-Day Secondary Service, Industrial Time-of-Day Primary Service, Commercial Time-of-Day Primary Service, Retail Transmission Service, Fluctuating Load Service, General Responsive Pricing Service, and special contracts.

change are consistent with LG&E's expectations, and there have been no concerns expressed by customers.

RATE OF RETURN

LG&E provided the outstanding balances for its long-term debt, short-term debt, and common equity as of February 28, 2015, the last expense 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, 2015.[13] Using this information, along with the currently approved 10.00 percent return on equity,[14] LG&E calculated an overall rate of return on capital, before income tax gross-up, of 6.70 percent.[15] LG&E also provided the overall rate of return on capital of 9.99 percent reflecting the tax gross-up approach approved in Case No. 2004-00421.[16]

LG&E has elected to take 50 percent bonus tax depreciation for 2015 as allowed by the 2014 Tax Increase Prevention Act which was passed in December 2014.[17] By doing so, LG&E will incur a tax loss for 2015 and therefore is not eligible for the Internal Revenue Code §199 ("§199 deduction") manufacturing tax deduction. The §199 deduction is not available to companies that do not have taxable income. The §199

[13] LG&E's response to Staff's First Request, Item 6.

[14] Case No. 2014-00372, *Application of Louisville Gas and Electric Company for an Adjustment of its Electric and Gas Rates* (Ky. PSC June 30, 2015).

[15] LG&E's response to Staff's First Request, Item 6.

[16] Case No. 2004-00421, *The Application of Louisville Gas and Electric Company for Approval of Its 2004 Compliance Plan for Recovery by Environmental Surcharge* (Ky. PSC June 20, 2005), and LG&E's response to Staff's First Request, Item 6. In the response, LG&E determined that the income tax gross-up factor was 0.61, which would produce a tax grossed-up weighted average cost of capital of 9.99 percent.

[17] H. Res. 5771, 113th Cong. (2014) (enacted.) The Act extended 50 percent bonus tax depreciation for qualified property placed in service before January 1, 2015. Prior to the law change, only long-production-period property with construction commencing before 2014 was eligible for the 50 percent bonus tax depreciation deduction in 2014.

deduction is a component of the gross-up revenue factor calculation, which in turn is a component in the overall rate of return calculation.

The effect of removing the §199 deduction is that the effective income tax rate is increased, thereby increasing the gross-up factor used in calculating the rate of return that is applied to the monthly environmental rate base. LG&E states that the increase would be partially offset by the reduction of the environmental rate base as the deferred income tax liability would be increased by the additional bonus tax depreciation. LG&E stated that taking bonus depreciation provides the greatest benefit to customers over the life of the property. LG&E provided a Net Present Value Revenue Requirement calculation that indicated electing to take bonus tax depreciation results in a benefit of $32.1 million over the life of the asset additions.[18] The Commission has reviewed and finds reasonable KU's decision to elect to take bonus depreciation for 2015.

The Commission has reviewed LG&E's determination of the overall rate of return on capital and finds 6.70 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. 2004-00421. Therefore, the Commission finds that the weighted average cost of capital of 6.70 percent and the income tax gross-up factor of 0.61, which produce an overall grossed-up return of 9.99 percent, should be used in all LG&E monthly environmental surcharge filings for the 2009 and 2011 Compliance Plans beginning in the second full billing month following the Commission's Final Order in this proceeding.

[18] LG&E's response to Commission Staff's Second Request for Information, Item 1.b.

OTHER ITEMS

LG&E proposed that its Environmental Cost Recovery Surcharge tariff ECR be updated to "clarify that the Off System Sales . . . tracker is included with the Fuel Adjustment Clause revenues included on ES Forms 3.00 and 3.10."[19] The proposed effective date of the revised tariff would be the month in which this Order is issued. The Commission has reviewed and finds reasonable LG&E's recommendation to update its Environmental Cost Recovery Surcharge tariff ECR as described herein.

IT IS THEREFORE ORDERED that:

1. LG&E's request to submit this case for a decision on the existing evidence of record without a hearing is granted.

2. The environmental surcharge amounts determined by LG&E for the review period ending April 30, 2015, are just and reasonable.

3. In the second full billing month following the month in which the Commission issues this Order, LG&E shall increase its jurisdictional environmental revenue requirement by $653,108 for three months.

4. LG&E shall roll $59,779,640 of incremental environmental surcharge amounts found to be just and reasonable herein into its existing base rates, for a total base rate environmental component of $73,663,008. The roll-in shall be allocated to the customer classes as described in the Settlement Agreement approved in Case No. 2011-00162 and in Case No. 2011-00232.

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[19] Conroy Testimony at 7.

5. LG&E shall use an overall rate of return on capital of 6.70 percent, a return-on-equity rate of 10.00 percent, a tax gross-up factor of 0.61, and an overall grossed-up return of 9.99 percent in all monthly environmental surcharge filings beginning in the second full billing month following the Commission's Final Order in this proceeding.

6. Within 20 days of the date of this Order, LG&E shall file with the Commission, using the Commission's electronic Tariff Filing System, 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. 2011-00232; other proposed language changes described herein; and a red-lined version of its tariffs.

By the Commission

ENTERED

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KENTUCKY PUBLIC SERVICE COMMISSION

ATTEST:

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