

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.
UTILITIES COMPANY FOR THE SIX-MONTH)	2015-00411
BILLING PERIOD ENDING OCTOBER 31, 2015)	

ORDER

On December 21, 2015, the Commission initiated a six-month review of Kentucky Utilities Company's ("KU") environmental surcharge as billed to customers for the six-month period beginning May 1, 2015, through October 31, 2015.¹ Pursuant to KRS 278.183(3), the Commission must review, at six-month intervals, the past operations of a utility's environmental surcharge. Also, pursuant to KRS 278.183(1), 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.

The December 21, 2015 Order also established a procedural schedule that provided for discovery, the filing of prepared testimony by KU, an informal conference, and intervenor testimony. KU filed prepared direct testimony and responded to a request for information issued by Commission Staff. On February 4, 2016, an informal conference was held at the Commission's offices to discuss the issues in this case. On March 4, 2016, KU requested that the Commission take this case under submission for

¹ KU's environmental surcharge is billed on a two-month lag. Thus, surcharge billings for May 2015 through October 2015 are based on costs incurred from March 2015 through August 2015.

decision based on the evidentiary record and issue an Order by March 31, 2016. Since there are no intervenors in this case and a hearing is not necessary in the public interest, the Commission will adjudicate this case based on the evidence of record.

SURCHARGE ADJUSTMENT

KU determined that it had a net under-recovery of environmental costs for the six-month billing period ended October 31, 2015, of \$1,309,732.² KU recommended that the Commission approve an increase to the jurisdictional environmental surcharge revenue requirement of \$654,866 per month for two months, beginning in the second full billing month following the Commission's Final Order in this proceeding.³ The two-month increase in the jurisdictional environmental surcharge revenue requirement would be achieved by increasing KU's environmental cost recovery billing factor for those same months.

The Commission has reviewed and finds reasonable KU's calculation of a net under-recovery of \$1,309,732 for the six-month billing period covered in this proceeding. The Commission also finds reasonable KU's proposal to recover this under-recovery by increasing the total jurisdictional environmental surcharge revenue requirement by \$654,866 per month 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 ended November 30, 2015, is 1,146 kilowatt hours ("kWh") per month.⁴ KU calculates that for a residential customer using 1,146 kWh per month, the

² Direct Testimony of Derek A. Rahn at 5.

³ *Id.* at 7.

⁴ KU's corrected response to Commission Staff's First Request for Information (filed Jan. 19, 2016) ("Staff's First Request"), Item 6.

impact of its proposed increase in environmental cost recovery billing factor would be an increase of approximately \$0.58 per month for two months, using rates and adjustment clause factors in effect for the November 2015 billing month.⁵

RATE OF RETURN

KU provided the outstanding balances for its long-term debt, short-term debt, and common equity as of August 31, 2015, 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 August 31, 2015.⁷ Using this information, along with the currently approved 10 percent return on equity,⁸ KU calculated a weighted average cost of capital, before income tax gross-up, of 6.92 percent for its 2009 and 2011 Environmental Compliance Plans (“Compliance Plans”).⁹ KU also provided the overall weighted average cost of capital reflecting the tax gross-up approach approved in Case No. 2004-00426.¹⁰

The Commission has reviewed KU's calculation of the weighted average cost of capital and finds that its use of 6.92 percent is reasonable for the Compliance Plans 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.

⁵ *Id.*

⁶ KU's revised response to Staff's First Request (filed Feb. 3, 2016), Item 5.

⁷ *Id.*

⁸ Case No. 2014-00371, *Application of Kentucky Utilities Company for an Adjustment of Its Electric Rates* (Ky. PSC June 30, 2015).

⁹ KU's revised response to Staff's First Request, 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 for Recovery by Environmental Surcharge* (Ky. PSC June 20, 2005); and KU's revised response to Staff's First Request, Item 5. In the response, KU determined that the income tax gross-up factor was 0.61, which would produce a tax grossed-up weighted average cost of capital of 10.30 percent.

2004-00426. The gross-up factor excludes the Internal Revenue Code §199 manufacturing tax deduction (“§199 deduction”) because KU incurred a tax loss for 2015 by taking bonus depreciation. The §199 deduction is not available to companies that do not have taxable income. Therefore, the Commission finds that the weighted average cost of capital for KU’s Compliance Plans of 6.92 percent and the income tax gross-up factor of 0.61, which produces an overall grossed-up return of 10.30 percent, should be used in all KU monthly environmental surcharge filings beginning in the second full billing month following the date of this Order.

IT IS THEREFORE ORDERED that:

1. The amounts billed to customers by KU through its environmental surcharge for the period from May 1, 2015, through October 31, 2015, are approved.

2. Beginning in the second full billing month following the date of this Order, KU shall increase its jurisdictional environmental revenue requirement by \$654,866 per month for two months.

3. Beginning in the second full billing month following the date of this Order, KU shall use an overall rate of return on capital of 6.92 percent, a tax gross-up factor of 0.61, a return on equity rate of 10.00 percent, and an overall grossed-up return of 10.30 percent in all future monthly environmental surcharge filings, unless directed otherwise by the Commission.

By the Commission

ENTERED ⁰⁷⁶
MAR 16 2016
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

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Case No. 2015-00411

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