

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF THE UNION LIGHT, HEAT AND	)	
POWER COMPANY FOR A CERTIFICATE OF PUBLIC	)	
CONVENIENCE TO ACQUIRE CERTAIN GENERATION	)	
RESOURCES AND RELATED PROPERTY; FOR	)	
APPROVAL OF CERTAIN PURCHASE POWER	)	CASE NO.
AGREEMENTS; FOR APPROVAL OF CERTAIN	)	2003-00252
ACCOUNTING TREATMENT; AND FOR APPROVAL OF	)	
DEVIATION FROM REQUIREMENTS OF KRS 278.2207	)	
AND 278.2213(6)	)	

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INTERIM ORDER

On July 21, 2003, The Union Light, Heat and Power Company (“ULH&P”) applied for a certificate of public convenience to acquire 1,105 megawatts (“MW”) of generating capacity from its parent company, The Cincinnati Gas and Electric Company (“CG&E”), and approval of: (1) certain purchase power agreements with CG&E; (2) certain accounting and rate-making treatments related to the proposed acquisition, and (3) a request to deviate from certain statutory requirements related to affiliate transactions.

The Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention (“AG”), is the only intervenor in this proceeding. ULH&P responded to two rounds of interrogatories by the AG and Commission Staff. The AG filed testimony of his expert witnesses on September 26, 2003 and responded to one round of interrogatories by ULH&P and Commission Staff. Informal conferences were held at the Commission’s offices on October 15, 21, and 24, 2003. On October 29, ULH&P filed an amendment to its application that changed several of the accounting and rate-making treatments proposed in its original application.

A public hearing was held on October 29 and 30, 2003. ULH&P and the AG filed responses to hearing data requests on November 7, 2003. Post-hearing briefs were received on November 19, 2003, and the case now stands submitted for decision.

#### SUMMARY OF DECISION

Having considered and thoroughly analyzed the evidence, we find that the proposed transfer is in the best interests of ULH&P and its ratepayers and should be approved, with some clarification and modification, subject to the Commission's review and approval of all transaction documents in their final form.<sup>1</sup> While this Commission cannot, in this transfer proceeding, render a decision on certain requests that will be binding on a future Commission in a ULH&P general rate case, we find that the related accounting and rate-making treatments proposed by ULH&P appear, at this time, to be reasonable.<sup>2</sup> We also find that ULH&P's requests to deviate from the Commission's statutory requirements regarding affiliate transactions and from our requirement that it analyze bids for purchased power in conjunction with its next Integrated Resource Plan ("IRP") filing are reasonable and should be granted.

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<sup>1</sup> Based on the evidence in this record, it appears that the proposed transaction is in the best interests of ULH&P's customers. The Commission urges that the federal agencies that must approve this transfer, the Federal Energy Regulatory Commission ("FERC") and the Securities and Exchange Commission ("SEC"), will give consideration to our findings in this proceeding when rendering their decisions.

<sup>2</sup> We recognize, however, that a change in law or compelling evidence to the contrary may require Commission consideration in ULH&P's next general rate case.

## BACKGROUND

In Case No. 2001-00058, the Commission approved a wholesale power contract under which ULH&P purchases power from CG&E as a full requirements customer.<sup>3</sup> That contract, scheduled to run through 2006, provides for ULH&P to purchase power from CG&E at a fixed price containing a market price component.<sup>4</sup> In its approval Order in that proceeding, the Commission expressed its interest in ULH&P acquiring generation in order to insulate itself from the impacts of market prices for wholesale power on a going-forward basis. The Commission also required ULH&P to file a stand-alone IRP no later than June 30, 2004 as a means of evaluating its future resource supply needs.<sup>5</sup> In its December 21, 2001 Order in Administrative Case No. 387, the Commission reiterated its concern regarding ULH&P's potential exposure to market prices in the future and also expressed concern that ULH&P had no announced plans for meeting its customers' power needs after the termination date of the current wholesale power contract.<sup>6</sup>

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<sup>3</sup> Case No. 2001-00058, The Application of The Union Light, Heat and Power Company for Certain Findings Under 15 U.S.C. § 79Z, final Order dated May 11, 2001, at 17.

<sup>4</sup> ULH&P and CG&E are both part of the Cinergy Corp. ("Cinergy") system. CG&E's rates to ULH&P include a market component due to its generating facilities being deregulated under Ohio's electric industry restructuring and FERC's mandate that wholesale rates be market-based rather than cost-based.

<sup>5</sup> In Case No. 2001-00058 ULH&P also agreed to freeze retail rate components that recover wholesale generation and transmission costs through December 31, 2006.

<sup>6</sup> Administrative Case No. 387, A Review of the Adequacy of Kentucky's Generation Capacity and Transmission System, final Order dated December 21, 2001, at 39-40.

ULH&P states that this application is its response to the concerns expressed by the Commission in those prior proceedings. Its proposal includes the acquisition of CG&E's 69 percent share of East Bend No. 2,<sup>7</sup> a 648 MW base load, coal-fired generating unit located in Rabbit Hash, Kentucky; Miami Fort No. 6, a 168 MW intermediate load, coal-fired generating unit located in North Bend, Ohio; and the 490 MW Woodsdale Generating Station, consisting of six peak load, gas or propane-fired generating units located in Trenton, Ohio.<sup>8</sup> Along with its application, ULH&P filed an independent due diligence assessment of the subject facilities, which was performed by Burns & McDonnell Engineering Company ("B&McD").<sup>9</sup>

#### ULH&P'S PROPOSAL

Under the amended application, the specific generating units will be transferred from CG&E to ULH&P at what is commonly referred to as net book value which, from a utility regulatory perspective, is defined as original cost less accumulated depreciation, with the original cost and the accumulated depreciation being carried forward to the accounting records of the acquiring entity. Because FERC and the SEC must rule upon the proposed transaction before it can be consummated, ULH&P and CG&E anticipate that the proposed transaction will not be completed until mid 2004. Although ULH&P

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<sup>7</sup> The Dayton Power and Light Company owns the remaining 31 percent.

<sup>8</sup> Under Ohio's electric industry restructuring plan, all the units proposed to be transferred were deregulated effective January 1, 2001. See Transcript of Evidence ("T.E."), Vol. I, October 29, 2003, at 221-222.

<sup>9</sup> Information on the facilities subject to the proposed transfer and B&McD's due diligence study of the facilities are included in Appendix A to this Order.

will acquire ownership of these units, Cinergy's generation fleet, including these units, will continue to be operated and dispatched on a system-wide, centralized basis.

ULH&P requests approval of a back-up power sale agreement ("PSA") under which CG&E will provide power to ULH&P when ULH&P's generation is not available to meet its system demand. It also requests approval of a purchase, sale and operation agreement ("PSOA") which will govern the terms of energy transfers between ULH&P and CG&E that occur for economic rather than reliability reasons. In addition to these agreements, ULH&P requests approval of assignment from CG&E of existing contracts governing the natural gas supply, propane fuel supply and propane storage at the Woodsdale site. The parties to these contracts are Cinergy Marketing and Trading, LP ("CMT"), Ohio River Valley Propane LLC ("ORVP"), affiliates within Cinergy, and TE Products Pipeline Company ("TEPPCO"), a non-affiliate company.<sup>10</sup>

In conjunction with the proposed acquisition of these generating units, ULH&P proposes specific accounting and rate-making treatments for certain revenues and costs, treatments it claims are necessary to make the transaction acceptable to CG&E and to maintain benefits that CG&E and Cinergy presently realize under the units' deregulated status. These accounting and rate-making treatments, as set forth in the amendment to ULH&P's application, are:

- (1) Fixing, for rate-making purposes, the value of the facilities being transferred at original cost less accumulated depreciation;
- (2) Deferring until ULH&P's next rate case a maximum of \$2.45 million in transaction costs incurred by ULH&P and CG&E related to the transfer of the specific units, with such costs amortized over 5 years without carrying charges;

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<sup>10</sup> ULH&P also requests approval of assignment from CG&E of the existing coal supply contracts for East Bend and Miami Fort No. 6.

- (3) Including in ULH&P's future base rates the capacity charges set out in the back-up PSA;
- (4) Including in ULH&P's future Fuel Adjustment Clause ("FAC") the costs of energy charges assessed under the back-up PSA and the costs of energy transfers from CG&E assessed under the PSOA;
- (5) Authorizing ULH&P to record accumulated deferred investment tax credits ("ADITC") and accumulated deferred income taxes ("deferred income taxes") transferred from CG&E "below the line" and to exclude the ADITC and deferred income taxes from retail rate-making in its next general rate case; and
- (6) In its next general rate case, permitting ratepayers to retain the first \$1 million in profits from off-system sales and 50 percent of profits above \$1 million, with ULH&P retaining the other 50 percent of any off-system sales profits in excess of \$1 million.<sup>11</sup>

ULH&P also requests approval to modify the IRP that it is required to file by June 30, 2004 to eliminate the requirement that the IRP include an evaluation of purchased power alternatives. In its amendment to its application, ULH&P commits to submit to the Commission for review and approval all final transaction documents prior to closing.

ULH&P requests approval to deviate from the affiliate transaction requirements of KRS 278.2207 through 278.2213 in order to effect the acquisition of the specific units and establish the proposed agreements with CG&E, CMT and OVRP. ULH&P also proposes to continue the rate freeze ordered in Case No. 2001-00058. It will honor its commitment to continue its rate freeze through 2006, and its commitment will apply to base rates, FAC charges, and environmental surcharges.

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<sup>11</sup> Off-system sales profits will be calculated by subtracting the incremental costs of such sales, as listed in paragraph 1.10 of the proposed PSOA, from the revenues generated through off-system sales.

## THE AG'S POSITION

The AG takes issue with certain aspects of ULH&P's proposal. Those are as follows:

- (1) The fact that ULH&P did not issue a Request for Proposals ("RFP") seeking offers of generating assets, purchase power agreements, or combinations thereof, to meet its future needs;
- (2) The request to fix the value of the facilities being transferred for future rate-making purposes;
- (3) The proposed deferral and recovery of transaction costs;
- (4) The proposal to record ADITC and deferred income taxes "below the line" and exclude them for retail rate-making in ULH&P's next general rate case;
- (5) ULH&P's proposed sharing of off-system sales profits; and
- (6) The FAC treatment of energy transfers made under the proposed PSOA.

The aspects of the proposal which the AG contests, or with which the AG disagrees, are discussed individually in the following paragraphs.

### Need for an RFP

The AG commends ULH&P and CG&E for working to provide a means by which ULH&P's rates can remain stable and ratepayers can be sheltered from the impact of market price fluctuations. However, he argues that without an RFP, ULH&P and the Commission cannot be assured that the offer from CG&E represents the least cost alternative for meeting ULH&P's future power supply needs. Among other things, the AG cites KRS 278.2207(2), arguing that ULH&P has not demonstrated that the pricing for the transfer and related agreements is at CG&E's or its other affiliates' fully



distributed costs, but in no event greater than market. The AG also contends that ULH&P has not demonstrated that the requested pricing is reasonable.

The AG cites the recent experiences of East Kentucky Power Cooperative, Inc. ("East Kentucky") and Louisville Gas and Electric Company and Kentucky Utilities Company ("LG&E/KU") in support of his argument. He refers to East Kentucky's recent application for approval to construct two combustion turbines ("CTs") based on the low bid it received in response to an RFP for peaking power. He also cites LG&E/KU's use of an RFP to demonstrate that purchasing CTs from a non-regulated affiliate was the least cost alternative for meeting their need for additional peaking capacity. The AG argues that an RFP is especially warranted when the transaction involves affiliates. He states that the acquisition price of the Woodsdale units exceeds the prices of the CTs acquired recently by East Kentucky and LG&E/KU; therefore, he concludes the price ULH&P is paying exceeds market.

ULH&P states that it did not issue an RFP for several reasons. First, it cites the recent and ongoing financial problems that have resulted in significant downgrades in the credit ratings of numerous electric industry participants, both regulated and non-regulated. Such downgrades have greatly increased credit risk concerns within the industry. Second, ULH&P indicates that the electricity market today focuses primarily on short-term contractual arrangements and that such a focus likely means that it would need to be back in the market for power within three to five years if it entered into a purchase power agreement at this time. Third, while acknowledging that a market exists for peaking generation such as CTs, ULH&P notes that there is not a comparable

market for base load capacity.<sup>12</sup> It also notes that there are no recent transactions similar to the proposed transaction, wherein a distribution utility attempted to acquire generation to supply its entire system or where facilities originally regulated, which were later deregulated, would go back under regulation.<sup>13</sup> Although an active market for base load capacity similar to the market for peaking capacity does not exist, ULH&P engaged ICF Consulting (“ICF”)<sup>14</sup> to prepare an analysis of the market value of the generating capacity that is the subject of the proposed transaction.<sup>15</sup> ICF’s analysis includes a base case scenario that shows the market value of the assets being transferred to be more than twice their book value. It also includes 11 sensitivities to reflect changes in assumptions such as demand levels, fuel prices, environmental regulations, and/or combinations of changes in various assumptions. Under each of the 11 sensitivities, the market value of the generating assets exceeds their book value.<sup>16</sup>

ULH&P points to the advantages of acquiring existing facilities with documented service histories and avoiding the risks inherent with siting and permitting new facilities. It also cites the advantages of acquiring generation facilities that are already integrated into the Cinergy transmission system and that will continue to be dispatched on a centralized basis along with the rest of the generation in the Cinergy system. Finally,

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<sup>12</sup> T.E., Vol. I, October 29, 2003, at 181-182.

<sup>13</sup> Id. at 182.

<sup>14</sup> ICF Consulting is an international consulting firm whose clients include the United States Environmental Protection Agency, Royal Bank of Canada, JP Morgan Securities, Inc., Moody’s Investors Service, other government entities and investment firms, along with utilities and regulatory commissions.

<sup>15</sup> Rose Direct Testimony, Attachments JLR-26 and JLR-26a.

<sup>16</sup> Id.

ULH&P states that the offer from CG&E may not remain available after it goes through the 6- to 9-month RFP process described by the AG. This is due to the potential for other parties to make purchase offers for some or all of the capacity or for wholesale power prices to increase to the point where CG&E decides that selling the output of the units in the market is in its best business interests.

The AG's arguments regarding the affiliate nature of the transaction and whether ULH&P has met its burden under KRS 278.2207(2) are not compelling. It is clear that the cost of the generating units to be transferred reflects CG&E's fully distributed costs. The record evidence is also very clear that the cost of the units is no greater than market. While the AG claims that the absence of an RFP leaves the Commission no alternative but to speculate as to the market price of alternatives to the proposed transaction, he ignores other measures of "market" prices. ICF's market analysis of the facilities being transferred, which the AG neither refuted or contested, is one such measure.

The AG's reliance on the recent CT proposals by East Kentucky and LG&E/KU does not consider any differences between those units and the Woodsdale units that could affect their relative costs. Some of those differences include: (1) Woodsdale's cost includes the cost of the land at that location; (2) Woodsdale's cost includes the cost of the pipelines that will be acquired with the generating units; and (3) the design of the Woodsdale units allows them to operate on either natural gas or propane. Furthermore, the AG has not demonstrated, in arguing as to whether prices are "no greater than market," that the Commission is required to review the components of the proposed transaction separately. Therefore, while the per cost kilowatt ("kw") of capacity of the

Woodsdale units may exceed the cost of the East Kentucky and LG&E/KU CTs, the cost of the total package of generating facilities that ULH&P proposes to acquire is substantially below market value as reflected in ICF's market analysis.

The Commission recognizes the AG's concerns and acknowledges that utilities under its jurisdiction typically conduct an RFP as part of the process of selecting new supply resources. We believe that such a process has benefited Kentucky's utilities and its ratepayers and that it will continue to benefit them in the future. However, in this instance, given the uniqueness of the proposed transaction, we are not persuaded that undertaking an RFP process would benefit ULH&P or its ratepayers. Attempting to acquire an entire generation fleet through a single transaction is unprecedented in the electric utility industry. Given the level of uncertainty that exists in the electric industry today, there are several arguments in favor of relying on factors other than the market or the financial strength of the firms that make up that market. Furthermore, based on ICF's market analysis, the facilities included in the transaction are being offered at an attractive price. As noted in the record, the average depreciated cost of the generating units included in the offer to ULH&P is \$332 per kw of capacity.<sup>17</sup> This compares to typical installed costs in today's electric industry of roughly \$350 to \$400 per kw for CTs and \$1,000, or more, per kw for base load coal-fired capacity.<sup>18</sup>

As evident both in Case No. 2001-00058 and Administrative Case No. 387, the Commission is on record as favoring ULH&P owning generation to serve the needs of

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<sup>17</sup> Id. at 183.

<sup>18</sup> Response to the Commission Staff's Hearing Data Request of October 29, 2003, Item 1.

its customers and to reduce its reliance on wholesale power purchases. Under the unique circumstances of this case, and given that the evidence demonstrates that a market for baseload capacity comparable to the market for peaking capacity does not exist, we find ULH&P's analysis of supply-side resource options to be reasonable. While CG&E's generation offer may not reflect the mix of facilities that ULH&P would seek under ideal circumstances, this "imperfection" does not persuade the Commission that the proposed transaction should be put on hold while ULH&P undertakes the process of issuing an RFP and evaluating the responses it receives thereto.<sup>19</sup>

Considering all relevant factors, we find that requiring ULH&P to conduct an RFP process is not necessary to determine the reasonableness of the proposed transfer of generating facilities. Based on a thorough review and analysis of the evidence of record, the Commission finds that it has other means of determining whether the proposed transfer is reasonable. We also find that ULH&P's acquisition of the facilities being offered by CG&E is in its best interests and the interests of its ratepayers. Having determined that an RFP is not necessary in this instance, we must still make a determination of whether the various conditions proposed by ULH&P are reasonable before ruling on whether to approve the transfer as proposed.

#### Transaction Costs

In its amended application, ULH&P requests that it be permitted to defer no more than \$2.45 million of transaction costs incurred in conjunction with the proposed acquisition. ULH&P also proposes that the deferred costs be amortized over 5 years,

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<sup>19</sup> The Commission notes that it has no statutory authority to require that CG&E sell any generation to ULH&P or to require CG&E to hold open its current offer until ULH&P has completed an RFP process.

without carrying charges, beginning on the effective date of the Commission's Order in its next general rate case.<sup>20</sup> ULH&P has estimated that the total transaction costs would be \$4.9 million, and would include transaction costs associated with filing preparation, financing, and taxes.<sup>21</sup>

The AG recommends that the transaction costs be deferred and recovered, but does not recommend that amortization begin with the next rate case. The AG suggests that, during the period between the transfer of the units and the next rate case, any profits generated by the units in excess of a reasonable rate of return be applied against the recovery of the deferred transaction costs. The AG believes this approach would reduce or possibly eliminate the deferred balance by the time of the next rate case.<sup>22</sup>

The Commission finds that ULH&P's proposal is reasonable and should be approved. Limiting the deferral provides for a sharing of the transaction costs between ULH&P's shareholders and ratepayers. The 5-year amortization period also represents a reasonable balance between the interests of these two groups. The exclusion of carrying charges on the deferred balance is consistent with the Commission's previous

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<sup>20</sup> Amendment to Application at 2-3.

<sup>21</sup> Steffen Direct Testimony, Attachment JPS-7. ULH&P explained that as a result of becoming "more comfortable" with certain aspects of Kentucky statutes and regulations, it decided to amend the application. The proposal to defer roughly half of the estimated transaction costs was one of the areas in which ULH&P felt comfortable in shifting the "balance more in customers' favor." See T.E., Volume I, October 29, 2003, at 16.

<sup>22</sup> King Direct Testimony at 10-11. The AG's testimony on this issue related to the original application and request to defer all the transaction costs and amortize those costs over 3 years. The AG did not address the treatment of the transaction costs as included in the amended application in testimony or in his brief.

decisions concerning situations in which the unamortized balance of a deferred cost is excluded from the rate base calculations during a general rate case.

#### ADITC and Deferred Income Taxes

As a result of Ohio's retail unbundling effective January 1, 2001, ADITC and deferred income tax balances associated with the generating units proposed to be transferred to ULH&P were reclassified as "below the line" and have been amortized "below the line" over the remaining lives of the plants. ULH&P proposes that ADITC and deferred income tax balances associated with the generating units be transferred from CG&E's books to ULH&P's books concurrent with the transfer of the units. ULH&P proposes that the transferred ADITC and deferred income tax balances remain "below the line" items on its books, amortized over the remaining lives of the units, and excluded from retail rate-making in ULH&P's future general rate proceedings. Any deferred income taxes generated after ULH&P owns the units would be "above the line" and included for rate-making purposes.<sup>23</sup> ULH&P acknowledges that the amortization expense associated with the "below the line" ADITC and deferred income tax balances would be recorded "below the line" as well.<sup>24</sup> As of March 31, 2003, the ADITC balance was \$7,404,258,<sup>25</sup> and the deferred income tax balance was \$83,388,148.<sup>26</sup>

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<sup>23</sup> Application at 9-10 and Steffen Direct Testimony at 12-13.

<sup>24</sup> T.E., Volume I, October 29, 2003, at 216-217.

<sup>25</sup> Response to the Commission Staff's First Data Request dated August 21, 2003, Item 51(a).

<sup>26</sup> Id., Item 52(a).

ULH&P argues that the proposed treatment for the ADITC and deferred income tax balances is reasonable. It states that the units included in the proposal were not subject to retail rate-making in Kentucky during the period when they were owned by CG&E, and concludes that ULH&P's ratepayers should not receive the benefit of the rate base reduction generally made by the Commission for ADITC and deferred income taxes.<sup>27</sup> ULH&P notes that the treatment proposed in this case is identical to that proposed and accepted in a recent plant transfer involving Cinergy affiliates in Indiana.<sup>28</sup> ULH&P also contends that the proposed treatment is consistent with Internal Revenue Service ("IRS") tax normalization requirements, and cites several IRS rulings in support of this conclusion.<sup>29</sup>

The AG opposes ULH&P's proposed treatment of the ADITC and deferred income tax balances. The AG argues that ULH&P's proposal will result in an overstated rate base, a distorted capital structure that will produce an overstated cost of equity, and an overstated income tax expense on a going-forward basis. The AG contends that the proposed treatment is at odds with conventional rate-making and that it does not recognize that the ADITC and deferred income tax balances represent customer-supplied capital that was provided while the plants were under regulation. The AG estimates that the revenue requirement impact of ULH&P's proposed treatment would

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<sup>27</sup> Id., Items 51(d)(1) and 52(c)(1).

<sup>28</sup> T.E., Volume I, October 29, 2003, at 222.

<sup>29</sup> Response to the Commission Staff's Hearing Data Request of October 29, 2003, Item 4. ULH&P cites a 1987 IRS General Counsel Memorandum and references several IRS Private Letter Rulings issued between 1987 and 1996.



be approximately \$341.9 million over the next 25 years.<sup>30</sup> The AG recommends that the ADITC balance be either subtracted from ULH&P's rate base or treated as zero-cost capital, with the ADITC balance amortized over the remaining lives of the plant "above the line" in order to recognize the source of the ADITC. The AG further recommends that the deferred income tax balance be accounted for "above the line" in accordance with the FERC Uniform System of Accounts ("FERC USoA").

ULH&P's proposed acquisition of generating facilities from CG&E represents an unprecedented transaction to be considered by the Commission. Not only must the Commission consider that the proposed transaction is between affiliated companies, it must also recognize that the generating assets being sold to the regulated entity have been deregulated. Consequently, the Commission must carefully consider the accounting and rate-making treatments authorized in conjunction with the proposed transaction, including the tax normalization impacts.

After reviewing the arguments and evidence, the Commission finds that the treatment of ADITC and deferred income taxes proposed by ULH&P is reasonable and should be approved. The generating units proposed to be transferred to ULH&P have been deregulated since January 1, 2001. When CG&E's regulated generating fleet became deregulated, the ADITC and deferred income tax balances were moved "below the line" for rate-making purposes. The possibility that some units of the deregulated generating fleet may be returning to regulation does not, in and of itself, support an assumption that the associated ADITC and deferred income tax balances will

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<sup>30</sup> AG's Response to Hearing Data Request filed November 7, 2003.

automatically move “above the line” for rate-making purposes. No evidence has been presented in this case that supports such an assumption.

ULH&P has provided the results of its research concerning the treatment of the ADITC and deferred income tax balances from a tax perspective. That research indicates that, upon the sale of public utility assets between two public utilities, ADITC cannot be added to the regulated books of the purchasing utility and that it cannot be flowed-through to the customers of either the buyer or seller. ULH&P’s research also indicates that, as the result of an asset sale and purchase transaction, any reduction of the purchaser’s cost of service for pre-transfer ADITC or deferred income tax balances would result in a tax normalization violation.

In addition, ULH&P’s proposal concerning the transfer of the deferred income taxes is consistent with the FERC USoA. In three separate account descriptions, the FERC USoA provides, “When plant is disposed of by transfer to a wholly owned subsidiary the related balance in this account shall also be transferred.”<sup>31</sup> However, the Commission notes that the FERC USoA addresses only the accounting treatment, and does not state for rate-making purposes whether the deferred income taxes are to be recorded “above the line” or “below the line.”

Concerning the AG’s estimated revenue requirement impact of ULH&P’s proposed treatment for ADITC and deferred income taxes, the Commission finds the estimate to be of little persuasive value. The AG has not consistently stated the amount

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<sup>31</sup> See FERC USoA, Account No. 281, Accumulated Deferred Income Taxes – Accelerated Amortization Property; Account No. 282, Accumulated Deferred Income Taxes – Other Property; and Account No. 283, Accumulated Deferred Income Taxes – Other.

of the estimated impact.<sup>32</sup> The Commission has examined the calculation of the \$341.9 million estimate and notes that the calculation assumes the rate of return on rate base and federal and state income tax rates to be constant over the approximate 25-year time frame covered by the estimate. The calculations include the determination of an annual return resulting from the AG's contention that there will be an excessive equity ratio. This annual return is also assumed to be constant, and is multiplied by 24.75 years to reflect its impact on the AG's revenue requirement. We note that ULH&P expressed similar concerns about the calculations in its brief.<sup>33</sup> The Commission does not believe that these assumptions produce a reasonable estimate of the revenue requirement impact of ULH&P's proposed rate-making treatment for ADITC and deferred income taxes. The Commission must consider all impacts of the proposal submitted rather than focus solely on the revenue requirement impact, as it appears the AG has done. Given the potential tax normalization issues, the lack of documentation supporting the AG's arguments, and the unrealistic assumptions contained in the AG's estimate of the revenue requirements impact, the Commission cannot consider the AG's position to be a reasonable alternative.

#### Profits from Off-System Sales

The AG argues that ratepayers should receive 90 percent of the profits from off-system sales and that ULH&P should be allowed to retain 10 percent as an incentive to

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<sup>32</sup> The AG did not include an estimate of the revenue requirement impact in his prefiled testimony. At the public hearing, the AG's witness stated the estimated impact was approximately \$200.0 million. See T.E., Volume II, October 30, 2003 at 43-44. In the AG's response to the hearing data request, the estimated revenue requirement was determined to be \$341.9 million. However, the AG's brief states that the impact on ULH&P's revenue requirement is \$317.7 million. See AG's Post Hearing Brief at 10.

<sup>33</sup> ULH&P Brief at 43-44.

make such sales. The AG states that ratepayers receive 100 percent of the profits from off-system sales under standard rate-making treatment, but recognizes that ULH&P should be given an incentive, albeit a small one, to make these sales. The AG also argues against ULH&P's proposed treatment of off-system sales profits on the basis that the proposal is not limited to sales made exclusively from the facilities being transferred. He claims the proposal would also apply to off-system sales derived from other assets that ULH&P could acquire while its proposed treatment of off-system sales profits was in place, which would produce an absurd result.

ULH&P acknowledges that the proposal to share off-system sales profits between customers and shareholders departs from typical rate-making treatment. However, it points out that, since Ohio's electric restructuring went into effect, CG&E has retained 100 percent of the profits from off-system sales from the units. ULH&P argues that this aspect of the proposal is critical to making the transaction acceptable to CG&E from an economic perspective.

The Commission finds ULH&P's proposal that ratepayers retain the first \$1 million in profits from off-system sales and 50 percent of profits above \$1 million to be acceptable. While it represents a departure from standard rate-making treatment, it represents an improvement for ratepayers compared to the current purchased power contract. As the contract is not cost-based, its pricing is not based on ratepayer retention of any off-system sales profits; hence, under ULH&P's proposal, ratepayers will be receiving a benefit from off-system sales that they had not received previously.

In addition, ULH&P forecasts annual off-system sales profits of \$4.5 million in the early years after the transfer, with the amount declining to \$1.6 million by 2012. Given

the uncertainty attendant to forecasting off-system sales, the guarantee of retaining up to the first \$1 million in profits from such sales is a significant benefit to ratepayers.

We recognize that this treatment does not comport with conventional rate-making; however, as stated elsewhere in this Order, this is not a conventional proceeding before this Commission. While ULH&P has referred to the sharing of off-system sales profits that has been approved for American Electric Power (“AEP”) in the past, this is largely an issue of first impression.<sup>34</sup> It is also, contrary to the AG’s brief, an issue applicable only to sales from the facilities that are the subject of the proposed transfer.<sup>35</sup>

For these reasons, and considering all provisions in the transaction as a whole, we find that the treatment of off-system sales profits proposed in the amendment to ULH&P’s application is reasonable. We further find no reason, at this time, that such treatment should not be approved in ULH&P’s next general rate proceeding.

#### FAC Treatment of Energy Transfers Under the PSOA

The AG does not disagree with ULH&P’s proposal to include the cost of energy transfers from CG&E to ULH&P for recovery through its future FAC. However, he argues that such treatment is appropriate only if credits that occur when ULH&P makes transfers to CG&E are also passed through the FAC. The amendment to ULH&P’s

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<sup>34</sup> AEP’s sharing of profits from off-system sales has no revenue requirement impact, as does ULH&P’s proposal. It involves a monthly comparison of such profits to the level (100%) of profits included in the revenue requirements determination in its prior general rate case.

<sup>35</sup> ULH&P’s application and testimony refer to off-system sales from the facilities being transferred and its amended application refers only to its next general rate case. To extend its proposal to include facilities that it might acquire in the future, ULH&P would have to file for and receive Commission approval.

application revised its original proposal, under which it would have retained 100 percent of the profits from off-system sales, such that ratepayers will receive the bulk of the profits from such sales. The proposal in ULH&P's original application would have precluded the AG's proposed treatment of the costs of energy transfers from ULH&P to CG&E. However, recognizing the change to both ULH&P's proposed treatment of off-system sales and its proposed treatment of energy transfers, as set out later in this Order in the section "Other Accounting and Rate-making Treatment Proposals," we conclude that passing through the FAC the credits that occur when ULH&P makes energy transfers to CG&E is entirely consistent with the FAC treatment prescribed in 807 KAR 5:056 and should, therefore, be approved, as proposed by the AG.

#### OTHER ISSUES

##### New Agreements and Contracts

ULH&P seeks approval of a form of asset transfer agreement for each of the three generating facilities included in the proposed transfer. A draft of the asset transfer agreement for East Bend was filed with the application.<sup>36</sup> Based on the amendment to ULH&P's application, the final agreements are expected to mirror the draft agreement, except for the deletion of provisions governing a "Regulatory Non-Satisfaction Event" and the "Purchase Option" both of which addressed circumstances that could lead to ULH&P transferring the facilities back to CG&E in the future.

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<sup>36</sup> Turner Direct Testimony, Attachment JLT-1.

In conjunction with the proposed transfer, ULH&P and CG&E will enter into the back-up PSA and PSOA described earlier in this Order.<sup>37</sup> The back-up PSA provides a firm supply of power for ULH&P's native load customers to replace capacity from either East Bend or Miami Fort when outages or deratings of those units occur.<sup>38</sup> Pricing terms under the back-up PSA call for energy to be priced at the average variable cost per MWh during the prior calendar month at the plant for which back-up power is required. The capacity charges ULH&P will pay under the back-up PSA are based on a value of power calculated using forward market prices quoted from Megawatt Daily and the North American Power 10x Report.<sup>39</sup> There are separate capacity charges for East Bend and Miami Fort which, on a combined basis, equal \$421,595 per month. The overall price for back-up power included in the PSA is less than the price embedded in ULH&P's existing wholesale purchase power contract with CG&E.

ULH&P and CG&E will also enter into the PSOA, which will allow the units being transferred to be jointly dispatched along with other Cinergy generating units. Energy transferred between ULH&P and CG&E under the PSOA will be priced at the market price for the hour in which the energy transfer takes place but will be capped at the receiving entity's incremental cost of available generation. The PSOA also establishes

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<sup>37</sup> Although the Commission can "approve" the back-up PSA and the PSOA as requested by ULH&P, because they both relate to wholesale transactions between ULH&P and CG&E, those agreements are subject to FERC's jurisdiction. Therefore, any approval thereof by the Commission would constitute an official endorsement of the agreements but would not constitute the final approval necessary.

<sup>38</sup> Woodsdale is not covered by the back-up PSA because it is peaking capacity, which will not operate for most hours of the year and will not be relied upon to meet ULH&P's base load requirements.

<sup>39</sup> McCarthy Direct Testimony, as adopted by M. Stephen Harkness, at 4.

the terms under which off-system purchases and sales will be made and how the costs and revenues associated with such transactions will be treated by ULH&P and CG&E.

For its operation of the Woodsdale station, CG&E presently has a contract with CMT to obtain its natural gas supply and contracts with ORVP to obtain propane and to store propane in a cavern partially owned by ORVP. CG&E also has a contract with TEPPCO to store propane in TEPPCO's pipeline system.<sup>40</sup> CG&E owns the pipelines used to transport propane to Woodsdale from both the ORVP cavern and the TEPPCO pipeline. ULH&P will acquire CG&E's pipelines as part of the proposed transaction.

Other than stating his concerns about the price of the facilities and the affiliate aspects of the proposed transaction, the AG did not oppose the form or content of the amended draft asset transfer agreement or ULH&P's proposal to enter into the back-up PSA and PSOA with CG&E. Likewise, the AG did not oppose CG&E's assignment of the "Woodsdale contracts" or its coal supply contracts to ULH&P. The Commission finds that the subject agreements and contracts are required in conjunction with the proposed transfer and, based on information in this record, appear to be reasonable and should therefore be approved, subject to our review and approval of the final documents.<sup>41</sup>

Several of the transaction documents have been and will be drafted to accomplish the proposed transaction. ULH&P commits to submit to the Commission for

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<sup>40</sup> CG&E also has non-affiliate contracts for the coal supply for East Bend and Miami Fort 6, which are to be assigned to ULH&P.

<sup>41</sup> It should be noted, due to their impact on ULH&P's base rates and/or future FAC charges, that both the back-up PSA and the PSOA are subject to periodic audit or review by the Commission.



review and approval the final documents prior to closing. ULH&P refers to 12 transaction documents that will be executed as part of the proposed transaction.<sup>42</sup> The Commission recognizes that the timing of the closing of the proposed transaction will be of significant concern to ULH&P and CG&E. However, the Commission must have adequate time to review the numerous documents related thereto.

Therefore, the Commission finds that a process should be established to address the review and approval of the transaction documents in their final form. ULH&P should submit all the transaction documents in their final form to the Commission no later than 30 days prior to the expected closing date of the transaction. The submitted documents should include all attachments, exhibits, appendices, and schedules that are referenced as part of the particular transaction document. For those documents it has already included in this record, ULH&P should include a detailed explanation for any changes made to the document from the version already existing in the record. For those documents not already included in this record, ULH&P should include a narrative describing the purpose of the document and explaining how the terms and conditions contained in the document are consistent with this Order. ULH&P should file an original and 5 copies of this information with the Commission and a copy with the AG.<sup>43</sup> Upon ULH&P's filing of these documents and explanations, the Commission will complete its review as expeditiously as possible.

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<sup>42</sup> The transaction documents identified in the record are listed in Appendix B of this Order.

<sup>43</sup> This docket will remain open to receive the final documents. The AG, as is his right as an intervenor, will have an opportunity to offer his opinion on those documents.

## Request for Deviation Regarding Affiliate Transactions

In 2000, the Kentucky General Assembly enacted guidelines on cost allocations and affiliate transactions, as well as a code of conduct for utilities with nonregulated activities or affiliates. These standards and guidelines are codified in Chapter 278 of the Kentucky Revised Statutes, specifically as KRS 278.2201 through KRS 278.2219. Provided within these statutes is the opportunity for regulated utilities to request from the Commission a waiver or deviation from the requirements thereof.

ULH&P requests permission to deviate from the requirements of KRS 278.2207(1)(b) and requests a waiver from the requirements of KRS 278.2213(6) for its plant acquisition transaction and certain affiliate agreements.<sup>44</sup> These statutes require, respectively, that the services and products provided to the utility by an affiliate be priced at the affiliate's fully distributed cost but in no event greater than market, and that all dealings between a utility and a nonregulated affiliate be conducted at arm's length. The Commission may grant a deviation from KRS 278.2207(1)(b) if it determines that the deviation is in the public interest. It shall grant a waiver or deviation from KRS 278.2207(1)(b) and/or KRS 278.2213 if it finds that compliance with the provisions thereof are impracticable or unreasonable.

The AG argues that ULH&P has failed to demonstrate to the Commission that a waiver or deviation from the provisions of KRS 278.2207 and KRS 278.2213 is

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<sup>44</sup> The affiliate agreements for which ULH&P requests deviation and waiver are the contract with CM&T that provides for CG&E to obtain natural gas for Woodsdale (Gas Supply and Management Agreement), the contract with ORVP for propane storage in the Todhunter propane cavern (Commodity Storage Agreement), and the contract CG&E has with ORVP to obtain propane for Woodsdale (Propane Supply and Management Agreement).

appropriate and asserts that ULH&P's request should be denied. The Commission does not agree.

In reviewing ULH&P's arguments justifying the lack of an RFP for the acquisition of the generating facilities and ICF's market analysis of those facilities, the Commission was able to determine that the generating units being transferred from CG&E are priced at CG&E's fully distributed cost and that the cost is below market. Therefore, the Commission finds that no deviation from KRS 278.2207(1)(b) is required for the acquisition of the generating units. The Commission is also satisfied from the evidence presented by ULH&P that the pricing of the products and services provided in the Gas Supply and Management Agreement, Commodity Storage Agreement, and the Propane Supply and Management Agreement is reasonable and that ULH&P's request to deviate from the pricing requirements of KRS 278.2207(1)(b) with regard to these agreements should be granted.

As stated previously, KRS 278.2213(6) requires that all dealings between a utility and its nonregulated affiliate be conducted at arm's length. Thus, a deviation from KRS 278.2213(6) is required for all of the agreements proposed by ULH&P in this proceeding, including the agreements for the generating units that the Commission has determined do not require a deviation from KRS 278.2207(1)(b).

Having reviewed ULH&P's reasons for not issuing an RFP and our previous findings herein that an RFP was not necessary to determine the reasonableness of the transfer of generating units, that the transfer is reasonable and in the public interest, and that the agreements associated with the transfer are in the public interest, the

Commission finds that ULH&P has met its burden under KRS 278.2219. Consequently, ULH&P's request to deviate from KRS 278.2213(6) should be granted.

The Commission finds, however, that the deviations approved herein should apply only to this transaction and the agreements discussed herein. Future transactions or successor agreements will require separate deviation or waiver requests if and when they are proposed by ULH&P.

#### Other Accounting and Rate-Making Treatment Proposals

In addition to its proposals regarding the value of the facilities being transferred, deferral and recovery of transaction costs, treatment of ADITC and deferred income taxes, and sharing the profits from off-system sales, ULH&P also requested approval of the following provisions related to the back-up PSA and the PSOA, to be effective with its next general rate case:

- (1) Inclusion in its future base rates of all monthly capacity charges specified in the back-up PSA; and a commitment to consult with the Commission and the AG prior to filing a successor agreement at FERC;
- (2) Inclusion in its future FAC of all energy charges assessed under the back-up PSA in accordance with 807 KAR 5:056 and Commission precedent;
- (3) Inclusion in its future FAC of the costs of energy transfers from CG&E under the PSOA in accordance with 807 KAR 5:056 and Commission precedent; and
- (4) Inclusion in its future FAC of the cost of the fuel consumed in the facilities in accordance with 807 KAR 5:056 and Commission precedent.

The Commission finds that this request is generally reasonable and should be approved. However, ULH&P did not specify what is meant by "Commission precedent" regarding its requested FAC treatment. Given that application and review of an electric

utility's FAC is addressed in its entirety in 807 KAR 5:056, the Commission will limit its decision herein to approving treatment in accordance with that administrative regulation.

#### Requirement to File a Stand-Alone IRP

In Case No. 2001-00058, the Commission required ULH&P to file a stand-alone IRP by June 30, 2004. Our Order stated that the IRP should include analyses of bids to purchase power from non-affiliated suppliers as well as construction of generation to lock in prices for the long term. In the amendment to its application, ULH&P requests that it be permitted to deviate from the requirement to analyze bids for purchased power. ULH&P states that, should the Commission approve the proposed transfer, such a requirement, which would impose significant costs on ULH&P, would no longer be necessary. Given that ULH&P's load forecast and supply-side analysis show that it will not need additional resources until the 2011-2012 time frame, and that this need is expected to be met with summer season purchases, the Commission finds that the requested deviation is reasonable and should be granted.

#### ULH&P's Next General Rate Case

Based on the current freeze on ULH&P's retail electric rates, effective through December 31, 2006, many of the accounting or rate-making provisions included in the amendment to its application refer to its next general rate proceeding or contain the phrasing "on or after January 1, 2007." These same references and phrasing were in ULH&P's original application and in numerous of its responses to data requests.

The Commission takes notice of the fact that ULH&P has not filed to increase its retail electric rates since 1991. By the end of the current rate freeze, its customers will have gone 15 years without a base rate increase. The Commission commends ULH&P

for its efficiency and its stewardship of ratepayers' monies, which have contributed to its not requiring a general rate increase for this length of time.

In some of its testimony and exhibits, ULH&P projected the future rate impact of acquiring the facilities that are the subject of the proposed transfer. Its projections show a possible future rate increase going into effect January 1, 2007, concurrent with the end of its current rate freeze. The Commission believes that a general rate proceeding will be necessary for ULH&P within that time frame. Given the numerous changes that have occurred in the electric industry since 1991, we believe that shareholders and ratepayers will both be better served in the long run by ULH&P filing a general rate application to effect a change in rates on January 1, 2007. Such an effective date, of course, would be at the conclusion of the suspension period provided by the statutes and regulations governing changes in rates. Therefore, we find that ULH&P should file a general rate application in 2006 to adjust its retail electric rates, so that, based on the suspension period applicable to ULH&P's choice of test period, the effective date of any eventual rate adjustment ordered by the Commission will be January 1, 2007.

#### Acceptance of Decision

The decision enunciated herein approves ULH&P's proposal, subject to certain conditions and modifications. Since the proposal was a response to concerns previously expressed by the Commission regarding ULH&P's long-term power supply needs, if any modifications are found to be unacceptable by ULH&P or its affiliates, the Commission wishes to be informed of that finding as soon as is practicable. Therefore, ULH&P should notify the Commission in writing, no later than 30 days from the date of

this Order, whether or not it and its affiliates accept this decision, including all modifications.

### FINDINGS AND ORDERS

Based on the evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. ULH&P's amendment to its application, which establishes the terms and conditions under which it will acquire CG&E's interests in East Bend Unit No. 2, Miami Fort Unit No. 6, Woodsdale Unit Nos. 1 through 6, and the related property, appurtenances, contracts and agreements, should be approved, subject to Commission review and approval of final drafts of the transaction documents.

2. The termination of ULH&P's current PSA with CG&E, effective on the closing date of the transfer of facilities, is reasonable and should be approved.

3. ULH&P should be granted a waiver, in accordance with KRS 278.2219, from the requirements of KRS 278.2213(6) that its acquisition of the facilities, subject to this transfer, from its affiliate, CG&E, be at arm's length; and ULH&P should be granted a deviation, pursuant to KRS 278.2207, of certain affiliate agreements related to the operation of the facilities being transferred.

4. ULH&P's draft transfer agreements for the three facilities being acquired, with the provisions governing a "Regulatory Non-Satisfaction Event" and the "Purchase Option" deleted, should be approved, subject to Commission review and approval of the agreements in their final form.

5. ULH&P's back-up PSA and its PSOA, which will govern its power transactions with CG&E on a going forward basis subsequent to the consummation of

the proposed transfer of facilities, should be approved, subject to Commission review and approval of the agreements in their final form.

6. The assignment to ULH&P by CG&E of CG&E's interests in the contracts for the supply, delivery, and storage of coal, oil, natural gas and propane used as fuel for electricity generation at East Bend Unit No. 2, Miami Fort Unit No. 6, and Woodsdale Unit Nos. 1 through 6 should be approved, subject to Commission review and approval of the contracts in their final form.

7. The facilities being acquired by ULH&P should be recorded by ULH&P at their original cost less accumulated depreciation. At this time, the Commission knows of no reason why such value should not be used in the future for rate-making purposes.

8. ULH&P should defer no more than \$2.45 million of the transaction costs incurred in relation to its acquisition of the subject generating facilities, with the costs to be deferred and amortized over 5 years, without carrying charges, beginning with the effective date of the Commission's Order in ULH&P's next general rate proceeding. At this time, the Commission knows of no reason why the resulting amortization expense should not be recovered through rates beginning with the effective date of the Commission's Order in ULH&P's next general rate proceeding.

9. ULH&P's proposal to record the ADITC and deferred income tax balances associated with the generating facilities being transferred "below the line" is reasonable and should be approved. At this time, the Commission knows of no reason why such treatment should not be reasonable for future rate-making purposes.

10. Based on its approval of the back-up PSA, the monthly capacity charges set out therein are reasonable. The Commission knows of no reason, at this time, why



such charges should not be recovered through rates beginning with the effective date of the our final Order in ULH&P's next general rate proceeding. ULH&P should consult with the Commission and the AG prior to filing any successor agreement with FERC.

11. ULH&P's recovery of energy charges assessed under the Back-Up PSA, from the date that its next FAC goes into effect, on or after January 1, 2007, should be in accordance with 807 KAR 5:056.

12. Treatment of the costs of energy transfers between ULH&P and CG&E under the PSOA, from the date that its next FAC goes into effect, on or after January 1, 2007, should be in accordance with 807 KAR 5:056.

13. ULH&P's proposal to share off-system sales profits with its customers, beginning with the effective date of the Commission's Order in its next general rate proceeding so that customers receive up to \$1 million from off-system sales profits annually and 50 percent of such profits above \$1 million annually, if any, while ULH&P retains 50 percent of the profits from off-system sales above \$1 million annually, if any, is reasonable. The costs attributable to off-system sales should include the incremental costs listed in the PSOA, Paragraph 1.10. ULH&P should implement the necessary processes to allocate appropriately said incremental costs to its off-system sales. The Commission knows of no reason, at this time, why such treatment of off-system sales profits should not be approved in ULH&P's next general rate proceeding.

14. ULH&P should be granted a waiver from the Commission's requirement, imposed in Case No. 2001-00058, that it analyze purchase power alternatives in its stand-alone IRP, which is to be filed by June 30, 2004.

15. ULH&P should file its next general rate application to adjust retail electric rates so that, based on the suspension period applicable to ULH&P's choice of test period, the effective date of any eventual rate adjustment ordered by the Commission will be January 1, 2007.

16. ULH&P should notify the Commission in writing, not later than 30 days from the date of this Order, if this decision, including all conditions and modifications, is acceptable to it and its affiliates.

17. ULH&P should submit the final draft versions of the various transaction documents and accompanying narrative explanations for final Commission review and approval in the manner described herein.

18. Within 10 days of their receipt, ULH&P should file one copy of each of the approval documents issued by the FERC and the SEC.

IT IS THEREFORE ORDERED that:

1. The proposed acquisition of generating facilities by ULH&P, as described in its amended application of October 29, 2003, is approved, subject to the conditions and modifications described in this Order.

2. Findings 2 through 15 shall be implemented as if the same were individually so ordered.

3. ULH&P shall notify the Commission in writing, not later than 30 days from the date of this Order, if this decision, including all conditions and modifications, is acceptable to it and its affiliates.

4. ULH&P shall submit the final draft versions of the various transaction documents and accompanying narrative explanations for final Commission review and approval in the manner described herein.

5. Within 10 days of their receipt, ULH&P shall file with the Commission one copy of each of the approval documents issued by the FERC and the SEC.

Done at Frankfort, Kentucky, this 5<sup>th</sup> day of December, 2003.

By the Commission

ATTEST:

  
Executive Director

## APPENDIX A

### APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2003-00252 DATED December 5, 2003

#### DESCRIPTION OF FACILITIES PROPOSED TO BE TRANSFERRED

##### East Bend No. 2

A 648 MW (nameplate rating ) coal-fired base load plant in Boone County, Kentucky. Commissioned in 1981, it is jointly owned by CG&E and Dayton Power and Light, with CG&E owning a 69% interest. The unit's net rating is 600 MW, after allowing for power used to operate the plant machinery. The net rating of CG&E's 69% share is 414 MW.

East Bend is designed to burn low- to high-sulfur eastern bituminous coal. Its recent achieved heat rates have ranged between 10,400 and 10,900 Btu/kWh. It is equipped with a lime-based flue gas desulfurization system (scrubber) along with a selective catalytic reduction (SCR) control system, which is designed to reduce NO<sub>x</sub> emissions by 85%. East Bend No. 2 has a 1.2 lbs./MMBTU SO<sub>2</sub> emission limit. The unit's output is directly connected to Cinergy's 345 kV transmission system.

Burns & McDonnell (B&McD) completed its due diligence review of East Bend in June 2003. Its personnel had visited the East Bend Generating Station on May 23, 2003. Its report concludes that the plant is fully capable of providing long-term, reliable service as a base load power facility if it continues to be properly operated and maintained in accordance with good utility practice. B&McD estimates that the unit's remaining useful operating life is at least 38 years.

##### Miami Fort No. 6

A 168 MW (nameplate rating) coal-fired base or intermediate load plant in Hamilton County, Ohio. Commissioned in 1960, it is one of four coal-fired units at the Miami Fort Generating Station. CG&E owns 100% of the unit, which has a net rating of 163 MW.

Miami Fort 6 is designed to burn low- to medium- sulfur eastern bituminous coal. Its recent heat rates have ranged between 9,900 and 10,200 Btu/kWh. It is equipped with a high efficiency electrostatic precipitator and with a temporary selective non-catalytic reduction (SNCR) system for NO<sub>x</sub> reductions. Miami Fort 6 has a 5.0 lbs./MMBTU SO<sub>2</sub> emission limit. The SNCR has not performed as well as expected and will be replaced with second generation low NO<sub>x</sub> burners in the future. It is directly connected to Cinergy's 138 kV transmission system.

B&McD visited the Miami Fort Generating Station on May 26, 2003. It shares a 600-foot tall exhaust stack and continuous emissions monitoring system with its sister unit, Miami Fort No. 5 as well as crushed coal conveyors. Miami Fort 6 also shares coal handling and fuel oil storage facilities with the three other units at the site. B&McD's report concludes that the plant is fully capable of providing long-term, reliable service as a base load/intermediate power facility if it continues to be properly operated and maintained in accordance with good utility practice. B&McD estimates that the unit's remaining useful operating life is at least 17 years.

### Woodsdale

A 490 MW (nameplate rating) six-unit combustion turbine station located in Butler County, Ohio. Its net summer capacity, including inlet cooling, is 500 MW. It is owned 100% by CG&E. The Woodsdale Generating Station was originally planned for twelve units, but only six units were constructed. It has dual fuel capability (natural gas and propane) and black start capability. Five units were commissioned in 1992 with the sixth unit commissioned in 1993.

Woodsdale is connected to two interstate natural gas transmission pipelines, Texas Eastern Transmission Company and Texas Gas Transmission Company. Its contracts with Ohio River Valley Propane LLC, an affiliate, provide for its propane supply and its propane storage. NO<sub>x</sub> emissions are controlled by water injection. Woodsdale's output is directly connected to Cinergy's 345 kV transmission system.

B&McD visited the Woodsdale Station on May 28, 2003. Its report noted that Units 5 and 6 had undergone major overhauls in 2001 and that Units 1-4 will have major overhauls in 2004-2005. B&McD's report concludes that the plant is fully capable of providing long-term, reliable service as a peaking power facility if it continues to be properly operated and maintained in accordance with good utility practice. B&McD indicated that the units' remaining useful operating lives will be dependent on the number of times the units are started and that, based on the number of starts that have occurred since the units were commissioned, they should be able to operate for several more years.

## APPENDIX B

### APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2003-00252 DATED December 5, 2003

#### TRANSACTION DOCUMENTS

##### Documents Filed with the Commission as of July 21, 2003:

- Asset Transfer Agreement for Unit 2 of the East Bend Generating Station (See Turner Direct Testimony, Attachment JLT-1)
- Back-up Power Sale Agreement (See McCarthy Direct Testimony, Attachment RCM-1)
- Purchase, Sales and Operation Agreement (See McCarthy Direct Testimony, Attachment RCM-2)

##### Documents Referenced But Not Filed with the Commission:

- Schedules referenced in Section 7.09 of the Asset Transfer Agreement for Unit 2 of the East Bend Generating Station
- Asset Transfer Agreement for Miami Fort 6
- Asset Transfer Agreement for Woodsdale
- Assignment Document for the Gas Supply and Management Agreement (See Roebel Direct Testimony, Attachment JJR-1 for copy of the current Gas Supply and Management Agreement)
- Assignment of the Commodity Storage Agreement (See Roebel Direct Testimony, Attachment JJR-2 for copy of the current Commodity Storage Agreement)
- Assignment of the Storage and Service Agreement (See Roebel Direct Testimony, Attachment JJR-3 for copy of the current Storage and Service Agreement)
- Assignment of the Propane Supply and Management Agreement (See Roebel Direct Testimony, Attachment JJR-4 for copy of the current Propane Supply and Management Agreement)

- Amendment/Assignment of current Coal Contracts
- Ownership transfer and lease back of shared stack at Miami Fort 5 and 6
- Use of shared coal handling and fuel oil storage facilities associated with Miami Fort 6





COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF THE UNION LIGHT, HEAT	)	
AND POWER COMPANY FOR A CERTIFICATE OF	)	
PUBLIC CONVENIENCE TO ACQUIRE CERTAIN	)	
GENERATION RESOURCES AND RELATED	)	CASE NO.
PROPERTY; FOR APPROVAL OF CERTAIN	)	2003-00252
PURCHASE POWER AGREEMENTS; FOR	)	
APPROVAL OF CERTAIN ACCOUNTING TREATMENT;	)	
AND FOR APPROVAL OF DEVIATION FROM	)	
REQUIREMENTS OF KRS 278.2207 AND 278.2213(6)	)	

O R D E R

On July 21, 2003, The Union Light, Heat and Power Company ("ULH&P") applied for a certificate of public convenience to acquire 1,105 megawatts ("Mw") of generating capacity from its parent company, The Cincinnati Gas and Electric Company ("CG&E"), and approval of: (1) certain purchase power agreements with CG&E; (2) certain accounting and rate-making treatments related to the proposed acquisition; and (3) requests to deviate from certain statutory requirements related to affiliate transactions.

The Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("AG"), is the only intervenor in this proceeding. A public hearing was held on October 29 and 30, 2003. The Commission issued an Interim Order granting preliminary approval to ULH&P's proposal, subject to certain conditions, on December 5, 2003.

In addition to the Commission's approval of the proposed transaction, ULH&P is required to obtain various approvals from the Federal Energy Regulatory Commission ("FERC") and the Securities and Exchange Commission ("SEC") before consummating

the transaction. Subsequent to receipt of our preliminary approval of the transaction, ULH&P sought the requisite FERC and SEC approvals. It has received the necessary FERC approvals and anticipates a decision on its SEC application in the near future.

Informal conferences attended by representatives of ULH&P, the AG, and the Commission Staff were held on January 11 and March 24, 2005 to discuss the status of the FERC and SEC proceedings and modifications to the proposed transaction that had occurred since the issuance of our Interim Order in this proceeding. On March 21 and 29, 2005, respectively, ULH&P submitted a compliance filing and supplemental compliance filing which detailed the proposed modifications. On May 10, 2005, ULH&P submitted an application for deviation from various Commission rules related to affiliate transactions, and on May 20, 2005 it submitted attachments which had inadvertently been omitted from the application for deviation.

#### BACKGROUND

ULH&P's proposal entails it acquiring CG&E's 69 percent share of East Bend No. 2,<sup>1</sup> a 648 Mw base load, coal-fired generating unit located in Rabbit Hash, Kentucky; Miami Fort No. 6, a 168 Mw intermediate load, coal-fired generating unit located in North Bend, Ohio; and the Woodsdale Generating Station, a 490 Mw facility consisting of 6 peak load, gas or propane-fired generating units located in Trenton, Ohio.

With its March 21, 2005 compliance filing and May 10, 2005 application for deviation, ULH&P seeks final approval of its acquisition of the CG&E generating units. ULH&P states that the factors that caused the proposed transfer to be in the public

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<sup>1</sup> The Dayton Power and Light Company owns the other 31 percent.

interest in 2003 are unchanged and that its acquisition of the CG&E generation assets continues to be in the public interest.

ULH&P also requests a waiver from the provisions contained in our Interim Order which require that it file final versions of the Back-up Power Supply Agreement with CG&E envisioned under the transfer and the amended or new coal and lime supply contracts for the East Bend and Miami Fort units in order to receive final Commission approval of the transfer. These waiver requests stem from ULH&P's decision to put its back-up power supply needs out for bid to address FERC's concerns about affiliate transactions and from changing conditions in the eastern United States coal industry that have contributed to delays in finalizing new coal supply agreements.

In addition, ULH&P requests approval for deviations from the affiliate transaction requirements of KRS 278.2207(1)(b) and 278.2213(6)<sup>2</sup> in order to: (1) engage in coal and lime supply transactions with CG&E until new coal and lime contracts are executed; (2) enter into an agreement for CG&E to operate, on ULH&P's behalf, the Miami Fort 6 unit and; (3) enter into an agreement for CG&E to provide gas and propane services to ULH&P at the Woodsdale Station. The deviation to engage in coal and lime supply transactions relates to the delays previously referenced concerning the execution of new coal contracts. The deviation for the Miami Fort 6 operation agreement stems from ULH&P's decision that CG&E should continue as the operator of the unit in order to retain the unit's existing Ohio environmental permits rather than ULH&P seeking to

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<sup>2</sup> KRS 278.2207(1)(b) requires all services and products provided to a utility by an affiliate to be priced at the affiliate's fully distributed cost, but in no event greater than market. KRS 278.2213(6) requires all dealings between a utility and a non-regulated affiliate to be at arm's length. The Commission is authorized to grant deviations from these requirements if requisite findings are reached.

obtain new permits for the unit. The deviation for gas and propane services at the Woodsdale Station results from a decision to retain the benefits of CG&E's Gas Operations Department continuing to provide operation and maintenance services to certain natural gas and propane facilities at the Woodsdale Station.

A final matter to be addressed in this proceeding is the timing of ULH&P's next Integrated Resource Plan ("IRP"). In response to concerns raised by the AG in this case, ULH&P filed an IRP in 2004 which was docketed in Case No. 2004-00014.<sup>3</sup> The final Order in that case stated:

While we are approving the IRP filed in this proceeding, we are not deciding when ULH&P's next IRP shall be filed. Due to the significance of the proposed CG&E to ULH&P generation asset transfer, we will defer a decision on the timing of ULH&P's next IRP until that matter is resolved in Case No. 2003-00252.

We note that the demand forecasts submitted by ULH&P in this case and in Case No. 2004-00014 reflect that, beyond the proposed acquisition of generating capacity from CG&E, no need for additional generating capacity is anticipated until 2011 – 2012. The Commission is also cognizant of ULH&P's previous interest in being able to efficiently coordinate its IRP filings with those of its affiliates operating in other jurisdictions. For these reasons, there does not appear to be an urgency in the filing of ULH&P's next IRP; however, we find that we should begin addressing the timing of such a filing.

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<sup>3</sup> Case No. 2004-00014, The Union Light, Heat and Power Company's Integrated Resource Plan, Order dated January 14, 2005.

## DISCUSSION

As ULH&P and CG&E worked through numerous agreements and conditions related to the proposed transfer over the past 18 months, various aspects of the terms of the transaction have been modified. Although none of the modifications appear to be cause for concern or require the Commission to alter its preliminary decision to approve the transfer, there are a number of issues that must be addressed at this time.

### Back-up Power Supply Agreement

Initially, ULH&P and CG&E proposed an agreement under which CG&E would provide the back-up power supply to meet ULH&P's needs. However, to mitigate concerns that FERC might have about less than-arms-length affiliate operating and pricing arrangements, ULH&P chose to bid out its back-up power supply needs. With ULH&P's rates frozen through 2006 and with it having the ability to take power from CG&E under the proposed Purchase, Sale and Operation Agreement, we find there is little expectation that the lack of a back-up power supply agreement on a short-term basis will negatively affect ULH&P ratepayers.

Since CG&E will continue to honor the terms it initially offered, all parties can be assured that the terms under which ULH&P ultimately receives back-up power supply services will be the same as or more favorable than the CG&E terms which received preliminary approval in our December 5, 2003 Interim Order. However, it is important for the Commission to remain apprised of this matter. Accordingly, ULH&P will be required to report to the Commission quarterly on the status of its selection of a source for back-up power supply services starting 3 months from the date of this Order. When

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it is executed, ULH&P will also be required to file the final back-up power supply contract for Commission approval. ②

#### Coal and Lime Supply Agreements

Originally, it was intended that the existing CG&E contracts, which supply the East Bend and Miami Fort units, would be assigned to ULH&P. However, as coal market conditions have evolved, CG&E and ULH&P began looking into system-wide, or "global" contracts, which could achieve economies of scale, permit coal shipments to be diverted to different generating stations, and allow CG&E and ULH&P to engage in coal sales and purchase transactions with each other. Until such time as a decision can be made on such contract, ULH&P requests that it be granted a deviation that would permit it to engage in coal and lime supply and transportation transactions for its plants with CG&E at fully distributed cost. ULH&P states that CG&E will continue to supply ULH&P coal and lime from the same contracts that serve the plants today. ULH&P states that continuing to be supplied under CG&E's current contracts allows it to take advantage of being part of a larger system and relieves it of the administrative burden of negotiating separate contracts during this interim decision period.

Given that ULH&P's rates, including its fuel costs, are frozen through 2006, we find the delay in entering into a new contract and in filing same with the Commission prior to approval of the asset transfer poses little risk to customers. In addition, any risk is further minimized since the Commission will continue to have the final approval authority over the contracts that are ultimately executed by ULH&P. We also find that ULH&P has met its burden under KRS 278.2207(2) and KRS 278.2219 and that the requested deviation from KRS 278.2207(1)(b) and KRS 278.2213(6) for the coal and

lime transactions should be granted. However, as previously stated, we find that ULH&P should make quarterly filings on the status of the coal and lime supply <sup>3</sup> agreements beginning 3 months from the date of this Order.

Deviation for CG&E's Operation of Miami Fort 6

ULH&P indicates that environmental permits are granted either to the owner or operator of a coal-fired generating unit in the state of Ohio. Having CG&E continue as the operator of Miami Fort 6, even though it will no longer own the unit, allows the existing environmental permits to remain in effect and avoids the risks attendant to the permitting process, which would be required if ULH&P were to be both owner and operator. In addition, ULH&P explains that Miami Fort 6 shares various plant and equipment with Miami Fort 5, including the exhaust stack containing the required continuous emission monitoring system ("CEMS"). It states that obtaining separate air permits for two generating units sharing a common stack might potentially trigger additional requirements as drastic as relocation of existing CEMS equipment, which would require additional expense and provide no additional value. It argues that even if it is not required to relocate the CEMS, additional administrative burdens and expenses would be incurred without additional benefits. ULH&P proposes to enter into an operation agreement with CG&E wherein ULH&P would reimburse CG&E the total costs incurred to operate Miami Fort 6 and requests that the Commission grant it the necessary deviations. Under the circumstances outlined by ULH&P, we find that the proposed at cost pricing is reasonable, that compliance with the arms-length transaction requirement would be impracticable, and that ULH&P should be granted the deviations requested and permitted to enter into the proposed operation agreement.

Deviation for CG&E to Provide Operation and Maintenance Services at Woodsdale

ULH&P proposes to enter into a Gas and Propane Services Agreement with CG&E wherein CG&E would agree to provide operation and maintenance services at Woodsdale to ULH&P at CG&E's fully distributed costs. ULH&P requests that the Commission grant it the necessary deviations that would allow it to enter into this agreement.

CG&E has the personnel and expertise to provide gas and propane operation and maintenance services, plus it has experience with the Woodsdale Station, having been the sole provider of these services since Woodsdale went into operation in the early 1990s. Furthermore, Woodsdale's southern Ohio location, in close proximity to CG&E's gas distribution facilities, makes it more economical and cost-effective for ULH&P to avail itself of such an arrangement rather than incur the additional travel expenses necessary to have its gas operations personnel perform these services. Given CG&E's experience and knowledge of the Woodsdale Station, we find that the pricing arrangement for this proposed transaction is reasonable and that it would be impracticable for ULH&P to comply with KRS 278.2213(6). Therefore, we find that the deviations requested should be approved and that ULH&P should be permitted to enter into the Gas and Propane Services Agreement.

The Timing of ULH&P's Next IRP

As previously stated, we find that the timing of ULH&P's next IRP is an issue that must be reviewed. However, given the reserve margin that ULH&P will have after the acquisition and its forecast of when it will need additional capacity, the Commission finds that a new IRP may not be required until the 2008–2010 time period. We also find



that input on this issue from both ULH&P and the AG should be considered before a final decision is reached. Therefore, we will require that ULH&P file, in a separate action, within 3 months of the date of this Order, a proposal along with supporting documentation, stating when it proposes to file its next IRP. In addition, the AG will be permitted to file written comments on the proposed IRP filing schedule within 30 days of the filing of ULH&P's proposal. ④

#### SEC Approval Issues

The Commission takes note that the Public Utilities Commission of Ohio recently filed a letter with the SEC which supports the statement of CG&E that the transfer will not have a material affect on retail market rates because it does not affect the regional market for electricity. We believe that ULH&P's assessment of the SEC's action on the transfer request is accurate and that the SEC will rule upon the request in the near future. However, since that decision is still pending, we will require that ULH&P include a status update on the SEC proceeding in its IRP compliance filing and require that it file the SEC decision document with the Commission within 10 days of the SEC's decision on the transfer. ⑤ ⑥

#### Other Filing Requirements

In a transaction of this magnitude, there are several matters of a "housekeeping" nature which the Commission believes must be addressed within this docket. These matters concern: (1) the documents executed as part of closing on the asset transfer transaction; (2) the accounting entries made by ULH&P to reflect the transaction; and (3) the breakdown of how ULH&P finances its acquisition of the CG&E generation assets. To address the first of these matters we will require ULH&P to file one complete

set of the final executed transaction documents in the record of this case. To address the second and third items we will require ULH&P to file the accounting entries made to reflect the generation asset transfer in its books and records along with explanations for how the amounts included in the entries were determined. These entries should reflect the decisions contained in our December 5, 2003 Interim Order concerning the "below the line" treatment of Accumulated Deferred Income Tax Credits and deferred income tax balances related to the transferred generating assets. The explanations for the accounting entries should also identify specific components of ULH&P's financing of the acquisition including, but not limited to, new debt issued, assumption of existing CG&E debt, and common equity issued.

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#### SUMMARY

The Commission, having considered the evidence of record and being otherwise sufficiently advised, finds that:

1. The proposed transfer of 1,105 Mw of generation assets from CG&E to ULH&P is in the public interest and should be approved.
2. ULH&P's request to deviate from the requirement in our December 5, 2003 Interim Order that it file final versions of its back-up power supply agreement and coal and lime supply contracts prior to obtaining final Commission approval of the transaction is reasonable and should be approved.
3. ULH&P's request for deviations from the provisions of KRS 278.2207(1)(b) and KRS 278.2213(6) should be granted as discussed herein.

4. The date for filing ULH&P's next IRP should be established in a separate proceeding and ULH&P and the AG should follow the process specified in Ordering Paragraph 5 of this Order.

5. ULH&P should update the Commission on the status of the SEC's review of the proposed transaction in accordance with the process specified in Ordering Paragraph 5 of this Order.

IT IS THEREFORE ORDERED that:

1. The proposed acquisition of generating facilities by ULH&P, as described in its October 29, 2003 amended application, as further modified in its March 21, 2005 compliance filing and May 10, 2005 application for deviation, is approved.

2. ULH&P's request to deviate from the requirement in our December 5, 2003 Interim Order that it file final versions of its back-up power supply agreement and coal and lime supply contracts prior to obtaining final Commission approval of the transaction is granted.

3. ULH&P shall file quarterly reports to keep the Commission apprised on the status of its efforts to enter into and consummate the final agreements and contracts envisioned as part of its acquisition of the generating facilities in question. The first of these reports shall be filed 90 days from the date of this Order with subsequent reports due every 90 days thereafter.

4. ULH&P's request for deviations from KRS 278.2207(1)(b) and KRS 278.2213(6) is granted for the transactions proposed herein.

5. Within 90 days from the date of this Order, ULH&P shall file, in a separate proceeding, a proposed date for the filing of its next IRP along with any

explanation it believes is appropriate to support its proposal. The AG is invited, but not required, to file comments on ULH&P's proposal within 30 days from the date of its filing.

6. Within 90 days from the date of this Order, ULH&P shall file a status update on the SEC's review of the proposed asset transfer transaction. It shall file the SEC decisions on the proposed transfer with the Commission within 10 days after its issuance by the SEC.

7. Except as modified herein, all other findings and orders contained in our December 5, 2003 Interim Order are incorporated herein and shall remain in full force and effect.

Done at Frankfort, Kentucky, this 17<sup>th</sup> day of June, 2005.

By the Commission

ATTEST:



Executive Director

Case No. 2003-00252



COMMONWEALTH OF KENTUCKY

RECEIVED

BEFORE THE PUBLIC SERVICE COMMISSION

JAN 12 2005

PUBLIC SERVICE  
COMMISSION

In the Matter of the Application of The Union )  
Light, Heat and Power Company for an Order )  
Authorizing the Issuance of First Mortgage )  
Bonds, Unsecured Debt, and Long Term Notes, )  
Issuance of Inter-Company Promissory Notes, )  
Execution and Delivery of Long-Term Loan )  
Agreements, and Use of Interest Rate )  
Management Instruments. )

Case No. 2005- 00027

**APPLICATION**

The Union Light, Heat and Power Company (ULH&P) respectfully petitions the Kentucky Public Service Commission (Commission), pursuant to KRS 278.300 and 807 KAR 5:001 Section 11, to authorize a financing program that includes the issuance of debt securities, execution, delivery or assumption of various loan agreements related to the issuance of tax-exempt bonds, issuance of inter-company unsecured promissory notes, the use of interest rate management instruments, and entrance into all necessary agreements and other documents relating thereto for the purpose of acquiring certain generating assets as approved by the Commission in Case No. 2003-00252<sup>1</sup> (Generation Acquisition), and for other general lawful purposes arising from the ongoing general financing needs of ULH&P, as more fully described herein. In support of this Application, ULH&P states as follows:

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<sup>1</sup> See *In the Matter of the Application of the Union Light, Heat and Power Company for a Certificate of Public Convenience to Acquire Certain Generation Resources and Related Property; for Approval of Certain Purchase Power Agreements; for Approval of Certain Accounting Treatment; and for Approval of Deviation from Requirements of KRS 278.2207 and 278.2213(6)*, Case No. 2003-00252 (Order issued December 5, 2003).

1. **Address:** ULH&P is a Kentucky corporation with its principal office and principal place of business at 1697A Monmouth Street, Newport Shopping Center, Newport, Kentucky 41071. The address of ULH&P's principal executive office is 139 East Fourth Street, Cincinnati, Ohio 45202.

2. **Articles of Incorporation:** Pursuant to 807 KAR 5:001, Section 8(3), ULH&P states that a certified copy of its Articles of Incorporation, as amended, is on file with the Commission in Case No. 6566.

3. **Statement of Business:** ULH&P is a utility as defined in KRS 278.010(3)(a) and (b), engaged in providing retail gas and electric services to its customers in Northern Kentucky in various municipalities and unincorporated areas of Kenton, Campbell, Boone, Gallatin, Grant, and Pendleton Counties. ULH&P is thus subject to the jurisdiction of the Commission.

4. **Acquisition of Generation.** As described in Case No. 2003-00252, ULH&P plans to acquire an ownership interest in three electric generating facilities from its parent company, The Cincinnati Gas & Electric Company (CG&E). These facilities include the East Bend Generating Station, Miami Fort Generating Station Unit 6, and the Woodsdale Generating Station (Plants). In testimony filed in Case No. 2003-00252, ULH&P described its plans to finance the Generation Acquisition to achieve a capital structure that supports a strong investment-grade credit rating, and stated that it would endeavor to achieve and maintain a structure consisting of approximately 50% debt and 50% equity.<sup>2</sup> ULH&P again submits that this target capital structure is reasonable considering ULH&P's evolution into a fully integrated electric utility provider. The

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<sup>2</sup> See Case No. 2003-00252, Direct Testimony of Gregorgy C. Ficke at 16 - 17.

financing instruments described herein are intended, in part, to finance the Generation Acquisition.

Additionally, the financing instruments described herein are designed to provide ULH&P the flexibility it needs on a going-forward basis to finance its operations and capital projects and maintain, as a fully integrated electric utility owning generating stations, strong investment-grade credit ratings well after the Generation Acquisition is closed.

5. **807 KAR 5:001 Section 11 (1) (a).** As of September 30, 2004, the net cost of the property, plant and equipment of ULH&P was \$409.2 million. Its principal properties consist of electric and gas distribution facilities. With the acquisition of generating assets from CG&E, ULH&P expects to add property on April 1, 2005 of approximately \$371.6 million thereby increasing its net cost of property, plant and equipment to approximately \$781 million.

6. **807 KAR 5:001 Section 11 (1) (b).** ULH&P proposes, and requests the Commission's approval of, a financing program permitting ULH&P to:

(a) issue and sell, from time to time over a period ending December 31, 2006, up to \$500 million principal amount of first mortgage bonds (the "Bonds"), senior or junior unsecured indebtedness (the "Debentures", and together with the Bonds, the "Securities"), or unregistered unsecured long-term notes (the "Long-Term Notes"), in any combination thereof and in one or more series, provided the aggregate of all such securities shall not exceed \$500 million;



- (b) issue at closing a long-term unsecured inter-company promissory note or notes (the “Inter-Company Promissory Notes”), up to an aggregate principal amount of \$200 million, as partial payment of the Generation Acquisition;
- (c) execute and deliver and/or assume, from time to time over a period ending December 31, 2006, one or more long-term loan agreements (the “Loan Agreements”) by which ULH&P would borrow from authorized issuers of tax-exempt bonds (the “Authority”), for terms not to exceed 40 years, the proceeds of up to a maximum of \$200 million aggregate principal amount of the Authority’s tax exempt bonds that may be issued in one or more series (the “Authority’s Bonds”); and
- (d) enter into Interest Rate Management Instruments to manage interest costs on its financial obligations (the “Interest Rate Management Instruments”).

The authority ULH&P seeks herein is intended to replace in its entirety the financing authority granted in Case No. 2004-00435.

### SECURITIES

- a. Method of Issuance. ULH&P proposes to either (i) sell the Securities to one or more purchasers or underwriters through negotiated offerings or (ii) sell the Securities through a competitive bidding process. In the event the Securities are sold through a negotiated offering, the terms of each offering of the Securities will be negotiated by ULH&P either with one or more underwriters, or with one or more purchasers for a direct sale or for a sale through agents. If the Securities are sold through competitive bidding, the Securities will be sold to the bidder(s) whose proposal results in the lowest annual cost of money, with ULH&P having the right to reject any or all bids. Each of the

bidders will be required to specify the coupon rate and the price, exclusive of accrued interest, to be paid for the Securities. Subject to approval of the terms for each offering by ULH&P's Board of Directors or by persons authorized by ULH&P's Board of Directors, it is anticipated that an agreement and other transaction documents setting forth the terms and conditions for issuance and sale of the Securities would be concluded.

b. Pricing Parameters. ULH&P has developed parameters under which the Securities are to be sold. The parameters, as set forth in Exhibit A, are designed to provide a reasonable allowance for potential changes in financial market conditions between the time of Commission authorization and the actual sale of the Securities. The inclusion of the parameters within the Order would allow ULH&P to sell the Securities on any day when it believes it is prudent to do so, provided the terms are within the parameters.

c. Security and Other Agreements. The Bonds will be issued under and secured by a first mortgage, either the first mortgage dated as of February 1, 1949 between ULH&P and The Bank of New York, Trustee, as amended and supplemented to date and as proposed to be supplemented by one or more supplemental indentures ("First Mortgage"), or a new first mortgage agreement with a trustee to be determined. If the Debentures are issued, they will be issued under an indenture, either the Indenture dated as of December 1, 2004, between ULH&P and Deutsche Bank Trust Company Americas, as Trustee, or its successor, as supplemented by one or more supplemental indentures, or a new indenture with a trustee to be determined.

d. Accounting. ULH&P proposes either to credit premiums or charge discounts, if any, and to charge the expenses to be incurred in connection with each issue to the proper

deferred accounts and amortize to current income such amounts over the respective lives of the Securities in equal annual amounts.

#### LONG-TERM NOTES

- a. Method of Borrowing. ULH&P proposes entering into one or more unsecured Long-Term Notes having a maturity date not less than 2 years and which may bear interest at either a fixed or variable rate. The obligation shall be evidenced by execution of a long-term note and a loan agreement or similar document under terms mutually agreeable to ULH&P and the lender and in conformity with generally accepted market conventions.
- b. Pricing Parameters. The Long-Term Notes will be issued under terms and conditions similar to the Debentures, except that the Long-Term Notes would typically be negotiated directly with one or more banks or other financial institutions, with less formality than is typical of the issuance and sale of a Debenture.
- c. Accounting. ULH&P proposes to charge the expenses to be incurred in connection with each Long-Term Note to the proper deferred accounts and amortize to current income such amounts over the respective lives of the Long-Term Notes in equal annual amounts.

#### INTER-COMPANY PROMISSORY NOTES.

ULH&P proposes to issue one or more Inter-Company Promissory Notes to CG&E in connection with the Generation Acquisition and from time to time as it deems necessary and appropriate as the most economical form of financing. With regard to the

Generation Acquisition, the Inter-Company Promissory Notes will be issued for a portion of the net book value of the generating assets, along with inventories, supplies and transaction costs at the time of closing of the purchase transaction, including amounts reflecting tax exempt debt related to assets to be owned by ULH&P, but in no case shall the Inter-Company Promissory Notes exceed an aggregate value of \$200 million. A portion of the Inter-Company Promissory Notes related to specific projects at East Bend Generating Station that qualified for tax-exempt financing will bear an interest rate per annum equal to the all-in weighted average cost of the specific underlying tax-exempt issuances applicable to East Bend Generating Station, with all-in cost to include the coupon interest rate plus any additional costs associated with amortization of financing charges and debt discounts associated with the tax exempt issuances. All other Inter-Company Promissory Notes will bear an interest rate per annum equal to the all-in weighted average cost of imbedded long-term debt (excluding tax exempt debt) of CG&E, with all-in cost to include the coupon interest rate plus any additional costs associated with amortization of financing charges and debt discounts associated with outstanding issuances of CG&E. The Promissory Note or Notes related to the Generation Acquisition will mature on or before December 31, 2039, and will be prepayable at the option of ULH&P, in whole or in part, at any time before the scheduled maturity, without penalty or premium.

With regard to the Generation Acquisition, by issuing a Promissory Note or Notes to CG&E, ULH&P will be able to avoid having to go to the capital markets for financing the acquisition of the generating assets immediately after receiving all necessary approvals. ULH&P will have a period of time to arrange for permanent financing for the

generating assets and will be able to retire the Inter-Company Promissory Notes prior to maturity at par if more advantageous financing becomes available. Today's market could not provide equivalent financing (with the same timing flexibility, no prepayment penalty, and subordinate to all other senior debt) at a cost below the cost of the Inter-Company Promissory Notes. A form of the promissory note is attached as Exhibit B.

### LOAN AGREEMENTS

ULH&P proposes to borrow from various Authorities the proceeds from the issuance by such Authorities of tax exempt bonds. ULH&P will enter into one or more Loan Agreements with the respective Authority to evidence and secure its obligations to repay such loans. ULH&P will use the proceeds from the loans to finance or reimburse the costs of acquiring and constructing certain solid waste facilities and other environmental-control facilities. ULH&P also proposes to assume responsibility for certain existing tax exempt debt under Loan Agreements between CG&E and the respective Authority to the extent any such indebtedness was incurred to finance any part of the Generating Assets being transferred to ULH&P.

a. ULH&P's Loan Obligations. ULH&P's obligations under each Loan Agreement will be to provide the Authority with sufficient revenues to enable it to pay all of the principal of, premium, if any, and interest on, the Authority's Bonds as and when any and all payments are due. ULH&P may procure bond insurance or a letter of credit to provide credit support for its payment obligations and/or ULH&P may issue First Mortgage Bonds to secure ULH&P's obligations under each individual Loan Agreement or as security for ULH&P's reimbursement obligations under the bond insurance agreements. Alternatively, ULH&P's payment obligations under the Loan Agreements

may be unsecured. First Mortgage Bonds may be in principal amounts equal to the aggregate principal amounts of the Authority's Bonds to which they relate (in which case they may provide for the payment of interest at the rate borne by the Authority's Bonds). Each Loan Agreement will stand alone, allowing ULH&P the option of securing or not securing its obligations under each Loan Agreement.

b. The Authority's Bonds. The Authority's Bonds have been (in the case of assumption of existing payment obligations) or will be issued pursuant to one or more Indentures of Trust (the "Indentures") to be entered into between the Authority and a trustee to be determined, which Indentures establish the terms of each series of the Authority's Bonds. The Authority's Bonds will be special obligations payable solely out of revenues derived from the payments by ULH&P under the respective Loan Agreements.

The Authority's Bonds or any series thereof may be entitled to the benefits of one or more letters of credit, may be entitled to the benefit of one or more bond insurance policies, or may be issued without the benefit of such letters of credit or insurance policies.

If a letter of credit is obtained, ULH&P would enter into a reimbursement agreement with a qualified financial institution issuing the letter of credit. Such reimbursement agreements would require ULH&P to reimburse the financial institutions for all drawings made under the letter of credit and to pay annual fees not in excess of one and one-half percent (1-1/2%) of the amount available under the letter of credit. The existence of a letter of credit securing payment of the Loan Agreements from a highly

rated financial institution would be expected to allow the sale of the Authority's Bonds with a lower interest rate than would exist without such a letter of credit.

Likewise, if bond insurance is obtained from a highly rated insurance company, the Authority's Bonds would be rated in a higher rating category than ULH&P's First Mortgage Bonds or Debentures by credit rating agencies and therefore would be expected to have a lower interest rate.

It is expected that bond counsel will render its opinion that, under existing laws, including regulations and official rulings by the Internal Revenue Service, interest on the Authority's Bonds will be excluded from gross income of the recipient thereof for federal income tax purposes, except for interest on any bond held by a substantial user or a related person as those terms are used in Section 147(a) of the Internal Revenue Code of 1986 as amended. Therefore, ULH&P expects the interest rate on the Authority's Bonds will be less than the interest rate ULH&P would be able to obtain on taxable bonds that ULH&P could issue with similar terms and conditions in the capital markets.

The terms of each offering of the Authority's Bonds will be negotiated by ULH&P with underwriters. After approval of the terms by ULH&P's Board of Directors and the Authority, ULH&P proposes to arrange for the sale of each series of the Authority's Bonds to the underwriters pursuant to one or more bond purchase agreements between the Authority and the underwriters, and pursuant to one or more representation letters from ULH&P to the Authority and the underwriters.

c. Pricing Parameters. ULH&P has developed parameters under which the Loan Agreements are to be executed, as set forth in Exhibit C. The inclusion of these parameters within the Order would allow ULH&P to execute and deliver the Loan

Agreements and any reimbursement or insurance agreements prior to the time ULH&P and the underwriters reach agreement with respect to the terms of the Authority's Bonds. If a series of the Authority's Bonds bears interest at a rate that is subject to adjustment, the same will also contain a feature that will allow the interest rate to become fixed under certain circumstances. ULH&P proposes the Commission include such limits in its order.

d. Assumption of Debt. ULH&P proposes the assumption of certain tax-exempt related obligations of CG&E in connection with the acquisition of generation assets from CG&E. These obligations of CG&E are evidenced by a Loan Agreement between CG&E and the Authority which obligations shall, through assignment, assumption or other agreement, become the obligations of ULH&P, which shall become responsible for payment of all associated interest, principal and related amortized expenses and discounts either directly to the trustee or by reimbursing CG&E. ULH&P may from time to time and subject to the Commission authority above, elect to issue the Authority's Bonds subject to a new Loan Agreement between ULH&P and the Authority directly and in place of CG&E. At such time, the Authority's Bonds shall become special obligations of ULH&P.

#### INTEREST RATE MANAGEMENT INSTRUMENTS.

a. General. ULH&P requests that this Commission grant it authority to enter into Interest Rate Management Instruments to manage its overall effective interest cost. Such authority will allow ULH&P sufficient alternatives and flexibility when striving to better manage its interest cost. Such authority was previously granted in Case No. 2001-00439.



b. Description of the Interest Rate Management Instruments. The Interest Rate Management Instruments will facilitate products commonly used in today's capital markets, consisting of interest rate swaps, caps, collars, floors, options, or hedging products such as forwards or futures, or similar products, the purpose of which being to manage interest costs. ULH&P expects to enter into Interest Rate Management Instruments with counterparties that are highly rated financial institutions. The transactions will be for a fixed period and a stated principal amount, and may be for underlying fixed or variable interest rate obligations of ULH&P.

c. Pricing Parameters. ULH&P proposes that the pricing parameters for Interest Rate Management Instruments be governed by the parameters corresponding to the underlying obligation in effect at its original issuance as specified in the Order authorizing such obligation by this Commission, if applicable.

Net fees and commissions in connection with any interest rate management agreement will be in addition to the above parameters and will not exceed 10% of the amount of the underlying obligation involved.

d. Accounting. ULH&P proposes to account for these transactions in accordance with generally accepted accounting principles.

e. Commission Authorization. Since market opportunities for these interest rate management alternatives are transitory, ULH&P must be able to execute interest rate management transactions when the opportunity arises to obtain the most competitive pricing. Thus, ULH&P seeks approval to enter into any or all of the described transactions within the parameters discussed above prior to the time ULH&P reaches agreement with respect to the terms of such transactions.

The authorization of the Interest Rate Management Instruments consistent with the parameters herein in no way relieves ULH&P of its responsibility to obtain the best terms available for the product selected and, therefore, it is appropriate and reasonable for this Commission to authorize ULH&P to agree to such terms and prices consistent with said parameters.

#### CONTRIBUTION OF CAPITAL

ULH&P anticipates receiving from CG&E contributed capital in connection with ULH&P's acquisition of generating assets from CG&E and from time to time to support a capitalization ratio at ULH&P that is compatible with and supports the ratings of a financially strong fully integrated electric utility. After approval of the terms for each receipt of contributed capital by ULH&P's Board of Directors or by persons authorized by ULH&P's Board of Directors, it is anticipated that, to the extent necessary, an agreement and other transaction documents setting forth the terms of the contributed capital would be concluded.

7. **807 KAR 5:001 Section 11 (1) (c).** The proceeds from the Securities, Long-Term Notes, Inter-Company Promissory Notes, and Loan Agreements, are expected to be used: (i) to repay a portion of ULH&P's short-term indebtedness; (ii) to redeem early long-term debt of ULH&P, if market conditions are favorable; (iii) to fund estimated future construction expenditures related to its gas delivery and electric generation, transmission and distribution businesses of \$86 million in 2005 and \$75 million in 2006;<sup>3</sup> (iv) for acquisition of generating assets from CG&E along with inventory and supplies and transaction costs; (v) for such additional expenditures as

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<sup>3</sup> These construction cost estimates do not include expenditures related to generating asset acquisition. Financing with respect to such expenditures will be addressed in a future filing.

contemplated by KRS 278.300; and/or (vi) for other lawful corporate purposes. The financing authority requested herein is necessary and appropriate for and consistent with the proper performance by ULH&P of its services to the public, will not impair its ability to perform those services, and is reasonably necessary and appropriate for such purposes.

8. **807 KAR 5:001 Section 11 (1) (d).** See Exhibit D concerning estimated construction expenditures, attached hereto, and made a part hereof.

9. **807 KAR 5:001 Section 11 (1) (e).** The short-term indebtedness expected to be discharged or partially discharged with the proceeds from the sale of the Securities consists primarily of short-term inter-company borrowings.

10. In Case No. 2001-00439 the Commission approved the issuance and sale of up to \$75,000,000 principal amount of First Mortgage Bonds or unsecured debt and the use of Interest Rate Management Instruments for the period ending December 31, 2004. As of the date of this filing, ULH&P has issued \$40,000,000 in unsecured indentures under this previous authority. Further, in Case No. 2003-00435, ULH&P requested that the Commission approve the issuance and sale of up to \$75,000,000 principal amount of First Mortgage Bonds or unsecured debt and the use of Interest Rate Management Instruments for the period ending December 31, 2006 – such application was granted by order dated December 17, 2004. The authority ULH&P seeks in this proceeding is intended to fully replace in its entirety the authority granted in Case No. 2004-00435.

11. **807 KAR 5:001 Section 6 and Section 11 (2) (a).** ULH&P is filing the following information in Exhibit E, which is incorporated herein and made a part of this application:

<u>Exhibit E</u> Page	<u>Description</u>	<u>807 KAR 5:001</u> <u>Section Reference</u>
	Financial Exhibit	6 and 11 (2) (a)
1	Amount and kinds of stock authorized	6 (1)
1	Amount and kinds of stock issued and outstanding	6 (2)
1	Terms of preference or preferred stock	6(3)
1	Brief description of each mortgage on property of ULH&P	6 (4)
2	Amount of bonds authorized and issued and related information	6 (5)
3	Notes outstanding and related information	6 (6)
3	Other indebtedness and related information	6 (7)
3	Dividend information	6 (8)
3-7	Detailed Income Statement and Balance Sheet	6 (9)

12. **807 KAR 5:001 Section 11 (2) (b).** The requested deeds of trust or mortgage documents indicated were filed in the following proceedings:

<u>Document</u>	<u>Style of Case</u>	<u>Case No.</u>	<u>Ex. No.</u>
First Mortgage February 1, 1949	In the Matter of the Application of The Union Light, Heat and Power Company for an Order Authorizing Issue of Capital Stock and First Mortgage Bonds	1797	5
First Supplemental Indenture	In the Matter of the Application of The Union Light, Heat and Power Company for an Order Authorizing a Ten-for-One Capital Stock Split, Changing Par Value from \$100 to \$15 per share Thereof and Transfer from Earned Surplus Account to Capital Stock Account the Sum Of \$1,247,904.26	2569	4

Second Supplemental Indenture May 1, 1954	In the Matter of the Application of The Union Light, Heat and Power Company for an Order Authorizing Issue of Additional Capital Stock	2896	3
Third Supplemental Indenture July 1, 1959	In the Matter of the Application of The Union Light, Heat and Power Company for an Order Authorizing Issue of Additional Capital Stock	3976	3
Fourth Supplemental Indenture July 1, 1963	In the Matter of the Application of The Union Light, Heat and Power Company for Authority to Issue up to \$6,000,000 of Short-term Bank Loans with no Maturity To Exceed 25 months	5085	3
Fifth Supplemental Indenture January 1, 1967	In the Matter of the Application of The Union Light, Heat and Power Company for Authority to Issue up to \$6,000,000 of Short-term Bank Loans with no Maturity to Exceed 25 months	5085	4
Sixth Supplemental Indenture June 1, 1970	In the Matter of the Application of The Union Light, Heat and Power Company for Authority to Issue up to \$5,000,000 of Short-term Bank Loans with no Maturity to Exceed 25 months	5567	3
Seventh Supplemental Indenture October 1, 1973	In the Matter of the Application of The Union Light, Heat and Power Company for Order Authorizing Issue of \$10,000,000 First Mortgage Bonds, Series Due 2003	7270	E
Eighth Supplemental Indenture December 1, 1978	In the Matter of the Application of The Union Light, Heat and Power Company for Order Authorizing Issue of \$10,000,000 First Mortgage Bonds, Series Due 2008	8387	C
Ninth Supplemental Indenture December 15, 1981	In the Matter of the Application of The Union Light, Heat and Power Company for Order Authorizing Issue and Sale of up to \$35,000,000 Principal Amount of First Mortgage Bonds	89-120	C
Tenth Supplemental	In the Matter of the Application of The Union Light, Heat and Power Company for Order	90-295	C

Indenture July 1, 1989	Authorizing Issue and Sale of up to \$55,000,000 Principal Amount of First Mortgage Bonds		
Eleventh Supplemental Indenture June 1, 1990	In the Matter of the Application of The Union Light, Heat and Power Company for Order Authorizing Issue and Sale of up to \$55,000,000 Principal Amount of First Mortgage Bonds	90-295	D
Twelfth Supplemental Indenture November 15, 1990	In the Matter of the Application of The Union Light, Heat and Power Company for Order Authorizing Issue of Capital Stock	92-418	B
Thirteenth Supplemental Indenture August 1, 1992	In the Matter of the Application of The Union Light, Heat and Power Company for Order Authorizing Issue of Capital Stock	92-418	C
Indenture December 1, 2004	In the Matter of the Application of The Union Light, Heat and Power Company for an Order Authorizing the (i) Issuance and Sale of up to \$75,000,000 Principal Amount of First Mortgage Bonds or Unsecured Debt and (ii) Use of Interest Rate Management Techniques	2001-00439	

13. **807 KAR 5:001 Section 11 (2) (c).** The proposed construction is primarily comprised of installations, improvements and extensions in the ordinary course of business. It is therefore impractical to submit maps and plans pertaining thereto. To the extent maps of the generating assets ULH&P intends to acquire from CG&E are necessary, ULH&P refers the Commission to those maps provided in Case No. 2003-00252.<sup>4</sup>

WHEREFORE, ULH&P asks that the Public Service Commission of the Commonwealth of Kentucky issue an order authorizing ULH&P to issue and sell up to \$900 million principal amount of its Securities, Long-Term Notes, Inter-Company Promissory Notes, Loan Agreements, or any combination thereof, and to utilize Interest

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<sup>4</sup> See Burns & McDonnell Due Diligence Evaluations filed in Case No. 2003-00252, July 21, 2003.

Rate Management Instruments, for the purposes herein stated and in a manner as herein set forth, and authorizing ULH&P to account for such Securities, Long-Term Notes, Inter-Company Promissory Notes, Loan Agreements, and Interest Rate Management Instruments in the manner as herein set forth.

Dated at Cincinnati, Ohio, this 11<sup>th</sup> day of January, 2005.

THE UNION LIGHT, HEAT AND POWER COMPANY

By: Wendy L. Aumiller  
Wendy L. Aumiller  
Treasurer

Its Attorneys:

John J. Finnigan, Jr.  
John J. Finnigan, Jr.  
Michael J. Pahutski  
The Union Light, Heat and Power Company  
139 East Fourth Street  
P.O. Box 960  
Cincinnati, Ohio 45201

VERIFICATION

State of Ohio            )  
                                  ) SS:  
County of Hamilton    )

Wendy L. Aumiller, being first duly sworn, deposes and says that she is Treasurer of ULH&P in the proceeding entitled above; that she has read the foregoing application and knows the contents thereof; and that the same is true of her own knowledge, except as to matters which are therein stated on information or belief, and that as to those matters she believes them to be true.

*Wendy L. Aumiller*  
Wendy L. Aumiller

Subscribed and sworn to before me, this 11<sup>th</sup> day of January, 2005.

*Anita M. Schaffer*  
Notary Public




**ANITA M. SCHAFER**  
Notary Public, State of Ohio  
My Commission Expires  
November 4, 2009



CERTIFICATE OF SERVICE

I hereby give notice that on this ~~11/4~~ day of January, 2005, a copy of the foregoing Application was served on the following party by regular U.S. mail, postage prepaid, or overnight mail delivery.

  
\_\_\_\_\_  
John J. Finnigan, Jr.

ELIZABETH E. BLACKFORD  
ASSISTANT ATTORNEY GENERAL  
OFFICE OF RATE INTERVENTION  
1024 CAPITAL CENTER DRIVE, SUITE 200  
FRANKFORT, KY 40601



COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF THE UNION LIGHT, HEAT	)	
AND POWER COMPANY FOR AN ORDER	)	
AUTHORIZING THE ISSUANCE OF FIRST	)	CASE NO.
MORTGAGE BONDS, UNSECURED DEBT, AND	)	2005-00027
LONG-TERM NOTES, ISSUANCE OF INTER-	)	
COMPANY PROMISSORY NOTES, EXECUTION	)	
AND DELIVERY OF LONG-TERM LOAN	)	
AGREEMENTS, AND USE OF INTEREST	)	
RATE MANAGEMENT INSTRUMENTS	)	

O R D E R

On January 12, 2005, The Union Light, Heat and Power Company ("ULH&P") filed its application for authority to establish a financing program of up to \$900 million<sup>1</sup> that includes the issuance of first mortgage bonds and debentures (together "the securities"), execution, delivery, or assumption of various loan agreements related to the issuance of tax-exempt bonds, issuance of inter-company unsecured promissory notes, the use of interest rate management instruments, and entrance into all necessary agreements and other documents relating thereto. On March 7, 2005, ULH&P amended its application, requesting in addition to the authority requested in its January 12, 2005 application, that the Commission authorize the assumption by ULH&P of debt

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<sup>1</sup> The \$900 million amount is the sum of the requested authorities; however, the different authorities will be interchangeable so that the total amount financed will be something less than \$900 million. As ULH&P's response to Item 4(a) of the First Data Request of Commission Staff dated February 10, 2005, states "The \$900 million is not an aggregate amount per se, but rather the sum of the requested authorities for each type of financing. For example, if a \$200 million inter-company note is utilized to partially finance the initial transfer of assets, it is anticipated that such note would be replaced with long-term financing using bonds when market conditions are favorable for such replacement."

of The Cincinnati Gas & Electric Company ("CG&E").<sup>2</sup> ULH&P states in its amended application that it has determined that management and mitigation of certain tax issues may be facilitated by the assumption of CG&E debt rather than the issuance of inter-company notes or debt.

Proceeds from the financing program are to be used to acquire certain generating assets from CG&E, the acquisition of which was preliminarily approved by the Commission in Case No. 2003-00252,<sup>3</sup> and for other general lawful purposes arising from the ongoing general financing needs of ULH&P. On April 1, 2005, ULH&P expects to add property related to the acquisition of generating assets of approximately \$371.6 million. ULH&P proposes to issue and sell, over a period of time ending December 31, 2006, up to an aggregate principal amount of \$500,000,000 in securities or unregistered unsecured long-term notes. ULH&P also proposes to enter into, over a period ending December 31, 2006, one or more long-term loan agreements by which it would borrow from issuers of tax-exempt bonds a maximum aggregate principal amount of \$200 million for terms not to exceed 40 years. In connection with the generation acquisition, ULH&P proposes to issue one or more inter-company promissory notes, or assume debt of CG&E as the transferor of the generating assets, up to an aggregate principal

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<sup>2</sup> The original application requested authority for ULH&P to assume tax exempt debt associated with the assets to be transferred to ULH&P. The amended application requests the additional authority for ULH&P to assume debt of CG&E in regard to the generation acquisition without regard to whether the debt is taxable or tax-exempt.

<sup>3</sup> Case No. 2003-00252, The Application of The Union Light, Heat and Power Company for a Certificate of Public Convenience and Necessity to Acquire Certain Generation Resources and Related Property; for Approval of Certain Purchase Power Agreements; for Approval of Certain Accounting Treatment; and for Approval of Deviation from Requirements of KRS 278.2207 and 278.2213(6), Order dated December 5, 2003.

amount of \$200 million. ULH&P also requests authority to enter into interest rate management instruments to manage its overall effective interest cost.

### Securities

ULH&P proposes certain parameters under which the securities are to be sold. These parameters, set forth in Exhibit A of the application, are designed to provide a reasonable allowance for potential changes in market conditions between the time of the Commission's authorization and the actual sale of the securities. Included in the parameters is a requirement that the interest rate is not to exceed those rates generally available at the time of pricing or re-pricing the bonds or unsecured indebtedness for securities having the same or reasonably similar maturities and having reasonably similar terms, conditions and features as securities issued by utility companies or holding companies of the same or reasonably comparable credit quality.

In Case No. 2001-00439,<sup>4</sup> the Commission expressed concern about ULH&P's request for market-based limits for its proposed securities. However, noting ULH&P's contention that the establishment of interest rate ceilings could result in missed opportunities in the capital markets and have negative impacts on its ability to operate, the Commission allowed such market-based rates. Our Order required, however, upon the issuance of securities, that ULH&P notify the Commission of the interest rate alternative selected for the issue. ULH&P was required to provide a detailed explanation as to how the alternative chosen represented the most reasonable interest

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<sup>4</sup> Case No. 2001-00439, The Application of The Union Light, Heat and Power Company For An Order Authorizing the (I) Issuance and Sale of Up To \$75,000,000 Principal Amount of First Mortgage Bonds or Unsecured Debt And (II) Use of Interest Rate Management Techniques, Order dated March 22, 2002 at 2.

rate available at the time of issuance. The explanation was to include a description of the specific interest rate management techniques and interest rate management agreements utilized by ULH&P for each issuance. ULH&P was also required to file copies of any interest rate management agreements executed in conjunction with the issuance.

For the current proposed securities, the Commission will allow ULH&P to continue to utilize market-based limits on interest rates. We will also require the same notification and reporting requirements as set forth in our Order in Case No. 2001-00439, as outlined herein.

#### Long-Term Notes

Long-term notes will be issued under terms and conditions similar to the securities. The notes will have a maturity of not less than two years and may bear interest at either a fixed or variable rate. Similar to the securities, the long-term notes are subject to market-based rates. The Commission will, therefore, require the same notification and reporting requirements for the issuance of long-term notes as required herein for the issuance of securities.

#### Inter-Company Promissory Notes/Assumption of Debt

ULH&P proposes to issue one or more inter-company promissory notes to CG&E, or to assume certain indebtedness of CG&E in connection with the generation acquisition and in situations when it is the most economical form of financing. The portion of the inter-company promissory notes related to specific projects at the East Bend generating station, which qualify for tax-exempt financing, will bear an interest rate equal to the all-in weighted average cost of the specific underlying tax-exempt

issuances applicable to East Bend. All other inter-company promissory notes will bear an interest rate equal to the all-in weighted average cost of imbedded long-term debt (excluding tax-exempt debt) of CG&E, including the coupon interest rate plus any additional costs associated with amortization of finance charges and debt discounts associated with outstanding issuances of CG&E. The promissory notes related to the generation acquisition will be prepayable, in whole or in part, at any time prior to the scheduled maturity, without penalty or premium. ULH&P states that equivalent financing could not be found in today's market at a cost below the inter-company promissory notes.

In its amended application, ULH&P proposes to assume debt of CG&E as an alternative to, or in combination with, the issuance of inter-company promissory notes. Upon the assumption of the debt, ULH&P would become responsible for payment of principal and interest and the other obligations set forth in the loan documentation of the debt assumed.

#### Loan Agreements

ULH&P proposes to borrow from various issuers, the proceeds from the issuance of tax exempt bonds. ULH&P will enter into loan agreements with the issuers of tax exempt bonds to evidence and secure its obligations to repay the loans. ULH&P also proposes certain parameters under which loan agreements can be executed, which are set forth in Exhibit C of the application. ULH&P proposes, if tax-exempt bonds bear interest that is subject to adjustment, that the bond will also contain a requirement that will allow the interest rate to be fixed under certain circumstances. Proceeds from the long-term loans will be used to finance or reimburse the costs of acquiring and

constructing solid waste facilities and other environmental control facilities. ULH&P expects that the interest rate on the issuer's tax-exempt bonds will be less than the interest rate that it would be able to obtain on taxable bonds that it could issue in the capital markets.

#### Interest Rate Management Instruments

In order to have sufficient alternatives and flexibility to better manage its interest cost, ULH&P requests authority to enter into interest rate management instruments. In Case No. 2001-00439, the Commission granted ULH&P similar authority. Interest rate swaps, caps, collars, floors, options or hedging instruments such as forwards or futures, or similar products could be used to manage interest costs. Pricing parameters in connection with any interest rate management agreement will be governed by the parameters corresponding to the underlying obligation in effect at its original issuance. Net fees and commissions will be in addition to those parameters and will not exceed 10 percent of the amount of the underlying obligation.

#### SUMMARY

ULH&P intends to use the proceeds from the securities, long-term notes, inter-company promissory notes, debt assumptions, and loan agreements to: (1) repay a portion of its short-term indebtedness, (2) redeem early portions of its long-term debt, (3) fund estimated future construction expenditures of \$86 million in 2005 and \$75 million in 2006 related to its gas delivery and electric generation, transmission and



distribution businesses,<sup>5</sup> (4) acquire generating assets from CG&E, and (5) fund additional expenditures as contemplated by KRS 278.300.

#### FINDINGS AND ORDERS

The Commission, having considered the evidence of record and being otherwise sufficiently advised, finds that the issuance and sale by ULH&P of securities, long-term notes, inter-company promissory notes, debt assumptions and loan agreements as set forth in its application are for lawful objects within its corporate purposes, are necessary and appropriate for and consistent with the proper performance of its service to the public, are reasonably necessary and appropriate for such purposes, and should therefore be approved. However, approval herein of the requested financing should in no way be considered final approval of the acquisition of the generating assets described and preliminarily approved in Case No. 2003-00252.

IT IS THEREFORE ORDERED that:

1. ULH&P is authorized to issue and sell up to \$500 million of its first mortgage bonds or unsecured indebtedness in one or more transactions through December 31, 2006.

2. ULH&P is authorized to issue a long-term, inter-company promissory note or notes, or assume debt of CG&E as the transferor of generation assets, in an aggregate principal amount of up to \$200 million, as partial payment of its generation acquisition, when it is the most economical form of financing for ULH&P.

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<sup>5</sup> Construction cost estimates do not include expenditures relating to generating asset acquisition.

3. ULH&P is authorized to execute and deliver over a period of time ending December 31, 2006, one or more long-term loan agreements by which it would borrow, from authorized issuers of tax-exempt bonds for terms not to exceed 40 years, the proceeds of up to a maximum aggregate principal amount of \$200 million of the authorized issuer's tax exempt bonds.

4 ULH&P is authorized to enter into such interest rate management instruments as needed to manage its interest costs on its financial obligations.

5. ULH&P shall, within 10 days after each issuance of the securities, or long-term notes referred to herein, file with the Commission a statement setting forth the date or dates of issuance, the price paid, the interest rate, the purchasers, and all fees and expenses, including underwriting discounts or commission or other compensation, involved in the issuance. In addition, ULH&P shall include a detailed explanation as to how the interest rate alternative chosen represents the most reasonable interest rate available at the time of issuance. The explanation shall include a description of the specific interest rate management techniques and interest rate management agreements utilized by ULH&P for each issuance, as well as copies of any executed interest rate management agreements.

6. ULH&P shall, within 10 days after each issuance of the inter-company promissory notes, or loan agreements referred to herein, file with the Commission a copy of any executed promissory note or loan agreement.

7. ULH&P shall, within 10 days after each assumption of CG&E debt, file with the Commission a copy of the debt assumption agreement between ULH&P and

CG&E. In addition, ULH&P shall include a detailed explanation of why it chose to assume existing debt of CG&E, rather than issue new long-term, inter-company notes.

8. ULH&P shall agree only to such terms and prices that are consistent with the parameters set out in its application.

9. The proceeds from the transactions authorized herein shall be used only for the lawful purposes set out in the application. ULH&P shall, within 10 days after each issuance of the financing instruments referred to herein, file with the Commission a statement setting forth the use of the proceeds from the issuance.

Nothing contained herein shall be construed as a finding of value for any purpose or as a warranty on the part of the Commonwealth of Kentucky or any agency thereof as to the securities authorized herein.

Done at Frankfort, Kentucky, this 13<sup>th</sup> day of April, 2005.

By the Commission

ATTEST:

  
Executive Director

Case No. 2005-00027



**The Union Light, Heat and Power Company**

**Summary of Securities Pricing Parameters**

<b>Principal Amount:</b>	Up to \$500 million of first mortgage bonds (the “Bonds”) or unsecured indebtedness (the “Debentures”), or any combination thereof, in one or more series.
<b>Maturity:</b>	Up to 40 years.
<b>Purpose:</b>	To refund outstanding obligations, for construction expenditures, or for other general purposes.
<b>Lead Underwriters:</b>	To be named.
<b>Underwriting Commissions or Agents’ Fees:</b>	Not to exceed 3.50% of the principal amount.
<b>Price to Public:</b>	No higher than 102% nor less than 98% of the principal amount, plus accrued interest, if any.
<b>Interest Rate:</b>	Not to exceed those generally obtainable at the time of pricing or re-pricing of such Bonds and Debentures for securities having the same or reasonably similar maturities and having reasonably similar terms, conditions and features issued by utility companies or utility holding companies of the same or reasonably comparable credit quality.



No. \_\_\_\_\_

\$ \_\_\_\_\_

**UNION LIGHT HEAT & POWER COMPANY**  
**\_\_\_% SUBORDINATED NOTE**  
**DUE \_\_\_\_\_**

UNION LIGHT, HEAT & POWER COMPANY, a corporation duly organized and existing under the laws of the state of Kentucky (herein called the "Company"), for value received, hereby promises to pay to ....., or registered assigns, the principal sum of ..... Dollars on ....., and to pay interest thereon from ..... or from the most recent interest payment date to which interest has been paid or duly provided for, semiannually on ..... and ..... in each year, commencing ....., at the rate of ...% per annum, until the principal hereof is paid or made available for payment.

Payment of the principal of and interest on this Note will be made at the office or agency of the Company maintained for that purpose in Cincinnati, Ohio, in such coin or currency of the United States of America as at the time of payment is legal tender for payment of public and private debts; provided, however, that at the option of the Company payment of interest may be made by check.

Interest on this Note shall be computed on the basis of a 360-day year of twelve 30-day months.

Any payment on this Note due on any day which is not a Business Day in the City of Cincinnati, Ohio need not be made on such day, but may be made on the next succeeding Business Day with the same force and effect as if made on the due date and no interest shall accrue for the period from and after such date. For purposes of this Note "Business Day," means each Monday, Tuesday, Wednesday, Thursday and Friday which is not a day on which banking institutions in Cincinnati, Ohio are authorized or obligated by law or executive order to close.

**Redemption**

This Note is subject to redemption upon not less than 30 days' notice by mail, at a redemption price equal to 100% of the principal amount, as a whole or in part, at the election of the Company, together with accrued interest to the redemption date.

In the event of redemption of this Note in part only, a new Note of like tenor for the unredeemed portion hereof will be issued in the name of the holder hereof upon the cancellation hereof.

## **Subordination**

The indebtedness evidenced by this Note is, to the extent and in the manner provided herein, expressly subordinate and subject in right of payment to the prior payment in full of all Senior Debt of the Company (as defined hereinbelow) whether outstanding at the date hereof or hereafter incurred. Each holder and owner of this Note, by accepting the same, agrees to and shall be bound by such provisions.

For purpose hereof, the "Senior Debt" of the Company means the principal of, premium, if any, interest on and any other payment due pursuant to any of the following, whether outstanding at the date of execution of this Note or thereafter incurred, created or assumed: (a) all indebtedness of the Company evidenced by notes, debentures, bonds or other securities sold by the Company for money, excluding this Note, but including all first mortgage bonds of the Company outstanding from time to time; (b) all indebtedness of others of the kinds described in the preceding clause (a) assumed by or guaranteed in any manner by the Company, including through an agreement to purchase, contingent or otherwise; and (c) all renewals, extensions or refundings of indebtedness of the kinds described in any of the preceding clauses (a) and (b); unless, in the case of any particular indebtedness, renewal, extension or refunding, the instrument creating or evidencing the same or the assumption or guarantee of the same expressly provides that such indebtedness, renewal, extension or refunding is not superior in right of payment to or is *pari passu* with this Note.

In the event and during the continuation of any default in the payment of principal, premium, interest or any other payment due on any Senior Debt continuing beyond the period of grace, if any, specified in the instrument evidencing such Senior Debt, unless and until such default shall have been cured or waived or shall have ceased to exist, or in the event that the maturity of any Senior Debt has been accelerated because of a default, then no payment shall be made by the Company with respect to the principal of or interest on this Note.

In the event that, notwithstanding the foregoing, any payment shall be received by the holder of this Note when such payment is prohibited by the preceding paragraph, such payment shall be held in trust for the benefit of, and shall be paid over or delivered to, the holders of Senior Debt or their respective representatives, or to the trustee or trustees under any indenture pursuant to which any of such Senior Debt may have been issued, as their respective interests may appear.

Upon any payment by the Company, or distribution of assets of the Company of any kind or character, whether in cash, property or securities, to creditors upon any dissolution or winding-up or liquidation or reorganization of the Company, whether voluntary or involuntary or in bankruptcy, insolvency, receivership or other proceedings, all amounts due or to become due upon all Senior Debt shall first be paid in full, or payment thereof provided for in money in accordance with its terms, before any payment is made on account of the principal or interest on this Note; and upon any such dissolution or winding-up or liquidation or reorganization any payment by the Company,



or distribution of assets of the Company of any kind or character, whether in cash, property or securities, to which the holder of this Note would be entitled, except for the provisions of this Note, shall be paid by the Company or by any receiver, trustee in bankruptcy, liquidating trustee, agent or other person making such payment or distribution, or by the holder of this Note if received by it, directly to the holders of Senior Debt (pro rata to such holders on the basis of the respective amounts of Senior Debt held by such holders, as calculated by the Company) or their representative or representatives, or to the trustee or trustees under any indenture pursuant to which any instruments evidencing any Senior Debt may have been issued, as their respective interests may appear, to the extent necessary to pay all Senior Debt in full, in money or money's worth, after giving effect to any concurrent payment or distribution to or for the holders of Senior Debt, before any payment or distribution is made to the holder of this Note.

In the event that, notwithstanding the foregoing, any payment or distribution of assets of the Company of any kind or character, whether in cash, property or securities, prohibited by the foregoing, shall be received by the holder of this Note before all Senior Debt is paid in full, or provision is made for such payment in money in accordance with its terms, such payment or distribution shall be held in trust for the benefit of and shall be paid over or delivered to the holders of Senior Debt or their representative or representatives, or to the trustee or trustees under any indenture pursuant to which any instruments evidencing any Senior Debt may have been issued, as their respective interests may appear, as calculated by the Company, for application to the payment of all Senior Debt remaining unpaid to the extent necessary to pay all Senior Debt in full in money in accordance with its terms, after giving effect to any concurrent payment or distribution to or for the holders of such Senior Debt.

For purposes of this Note, the words, "cash, property or securities" shall not be deemed to include shares of stock of the Company as reorganized or readjusted, or securities of the Company or any other corporation provided for by a plan of reorganization or readjustment, the payment of which is subordinated with respect to this Note to the payment of all Senior Debt which may at the time be outstanding; provided that (i) the Senior Debt is assumed by the new corporation, if any, resulting from any such reorganization or readjustment, and (ii) the rights of the holders of the Senior Debt are not, without the consent of such holders, altered by such reorganization or readjustment. The consolidation of the Company with, or the merger of the Company into, another corporation or the liquidation or dissolution of the Company following the conveyance or transfer of its property as an entirety, or substantially as an entirety, to another corporation upon the terms and conditions provided for in this Note shall not be deemed a dissolution, winding-up, liquidation or reorganization for the purposes hereunder if such other corporation shall, as a part of such consolidation, merger, conveyance or transfer, comply with the conditions stated hereunder.

Subject to the payment in full of all Senior Debt, the rights of the holder of this Note shall be subrogated to the rights of the holders of Senior Debt to receive payments or distributions of cash, property or securities of the Company applicable to the Senior Debt; and, for the purposes of such subrogation, no payment or distributions to the holders of the Senior Debt of any cash, property or securities to which the holder of this Note would be entitled except for the provisions hereunder, and no payment over to or for the benefit of the holders of Senior Debt by the holder of this Note, shall, as between the Company, its creditors other than holders of Senior Debt, and the holder of this Note, be deemed to be a payment by the Company to or on account of the Senior Debt. It is understood that the subordination provisions of this Note are and are intended solely for the purposes of defining the relative rights of the holder of this Note, on the one hand, and the holders of the Senior Debt on the other hand.

Nothing contained in this Note is intended to or shall impair, as between the Company, its creditors other than the holders of Senior Debt, and the holder of this Note, the obligation of the Company, which is absolute and unconditional, to pay the principal of and interest on this Note as and when the same shall become due and payable in accordance with their terms, or is intended to or shall affect the relative rights of the holder of this Note and creditors of the Company other than the holders of the Senior Debt, nor shall anything herein or therein prevent the holder of this Note from exercising all remedies otherwise permitted by applicable law upon default hereunder, subject to the rights, if any, of the holders of Senior Debt in respect of cash, property or securities of the Company received upon the exercise of any such remedy.

#### **Events of Default**

“Event of Default,” wherever used herein with respect to this Note, means any one of the following events (whatever the reason for such Event of Default and whether it shall be voluntary or involuntary or be effected by operation of law or pursuant to any judgment, decree or order of any court or any order, rule or regulation of any administrative or governmental body):

- (1) default in the payment of any interest upon this Note when it becomes due and payable, and continuance of such default for a period of 30 days; or
- (2) default in the payment of the principal of this Note at its maturity; or
- (3) default in the performance, or breach, of any covenant or warranty of the Company in this Note (other than a covenant or warranty a default in whose performance or whose breach is elsewhere specifically dealt with) and continuance of such default or breach for a period of 90 days after there has been given, by registered or certified mail, to the Company by the holder of the Note a written notice specifying such default or breach and requiring it to be remedied and stating that such notice is a “Notice of Default” hereunder; or

(4) the entry by a court having jurisdiction in the premises of (A) a decree or order for relief in respect of the Company in an involuntary case or proceeding under any applicable Federal or state bankruptcy, insolvency, reorganization or other similar law or (B) a decree or order adjudging the Company a bankrupt or insolvent, or approving as properly filed a petition seeking reorganization, arrangement, adjustment or composition of or in respect of the Company under any applicable Federal or state law, or appointing a custodian, receiver, liquidator, assignee, trustee, sequestrator or other similar official of the Company or of any substantial part of its property, or ordering the winding up or liquidation of its affairs, and the continuance of any such decree or order for relief or any such other decree or order un-stayed and in effect for a period of 90 consecutive days; or

(5) the commencement by the Company of a voluntary case or proceeding under any applicable Federal or state bankruptcy, insolvency, reorganization or other similar law or of any other case or proceeding to be adjudicated a bankrupt or insolvent, or the consent by it to the entry of a decree or order for relief in respect of the Company in an involuntary case or proceeding under any applicable Federal or state bankruptcy, insolvency, reorganization or other similar law or to the commencement of any bankruptcy or insolvency case or proceeding against it, or the filing by it of a petition or answer or consent seeking reorganization or relief under any applicable Federal or state law, or the consent by it to the filing of such petition or to the appointment of, or taking possession of the Company or of any substantial part of its property by, a custodian, receiver, liquidator, assignee, trustee, sequestrator or other similar official or the making by the Company of an assignment for the benefit of creditors, or the admission by it in writing of its inability to pay its debts generally as they become due, or the taking of corporate action by the Company in furtherance of any such action; or

If an Event of Default (other than an Event of Default specified in paragraphs (4) or (5) above) occurs and is continuing, then the holder of this Note may declare the principal amount to be due and payable immediately, by a notice in writing to the Company, and upon any such declaration such principal amount shall become immediately due and payable. If an Event of Default specified in paragraphs (4) or (5) above occurs, the principal amount of this Note shall automatically, and without any declaration or other action on the part of the holder, become immediately due and payable.

No delay or omission of the holder of this Note to exercise any right or remedy accruing upon any Event of Default shall impair any such right or remedy or constitute a waiver of any such Event of Default or an acquiescence therein. Every right and remedy given by this Note or by law to the holder may be exercised from time to time, and as often as may be deemed expedient, by the holders.

### **Consolidations and Mergers Permitted**

Nothing contained in this Note shall prevent any consolidation or merger of the Company with or into any other corporation or corporations (whether or not affiliated with the Company), or successive consolidations or mergers in which the Company or its successor or successors shall be a party or parties, or shall prevent any sale, conveyance, transfer or other disposition of the property of the Company or its successor or successors as an entirety, or substantially as an entirety, to any other corporation (whether or not affiliated with the Company or its successor or successors) authorized to acquire and operate the same; provided, however, the Company hereby covenants and agrees that, upon any such consolidation, merger, sale, conveyance, transfer or other disposition, the due and punctual payment of the principal of and interest on this Note in accordance with its terms, according to its tenor, and the due and punctual performance and observance of all the covenants and conditions of hereunder to be kept or performed by the Company, shall be expressly assumed, by written agreement satisfactory in form to the holder executed and delivered to the holder by the entity formed by such consolidation, or into which the Company shall have been merged, or by the entity which shall have acquired such property.

In case of any such consolidation, merger, sale, conveyance, transfer or other disposition and upon the assumption by the successor corporation of the due and punctual payment of the principal of and interest on this Note and the due and punctual performance of all of the covenants and conditions hereunder to be performed by the Company, such successor corporation shall succeed to and be substituted for the Company, with the same effect as if it had been named herein as the party of the first part, and thereupon the predecessor corporation shall be relieved of all obligations and covenants under this Note.

Nothing contained in this Note shall prevent the Company from merging into itself or acquiring by purchase or otherwise all or any part of the property of any other corporation (whether or not affiliated with the Company).

IN WITNESS WHEREOF, the Company has caused this instrument to be duly executed.

Dated:

**UNION LIGHT, HEAT & POWER COMPANY**

**By:**  
**Name:** \_\_\_\_\_

**Title:** \_\_\_\_\_



**The Union Light, Heat and Power Company**

**Summary of Loan Agreement Pricing Parameters**

<b>Principal Amount:</b>	Up to \$200 million of tax exempt bonds, in one or more series.
<b>Maturity:</b>	Up to 40 years.
<b>Purpose:</b>	To finance or reimburse the costs of acquiring and/or constructing certain solid waste facilities or other environmental-control facilities.
<b>Lead Underwriters:</b>	To be named.
<b>Underwriting Commissions or Agents' Fees:</b>	Not to exceed 1.25% of the principal amount.
<b>Price to Public:</b>	No higher than 101-1/2% nor less than 98% of the principal amount, plus accrued interest, if any.
<b>Interest Rate:</b>	Not to exceed those generally obtainable at the time of pricing or re-pricing of such Loan Agreements for instruments having the same or reasonably similar maturities and having reasonably similar terms, conditions and features issued by utility companies or utility holding companies of the same or reasonably comparable credit quality. The public offering price will be no higher than 101-1/2% nor less than 98% of the principal amount of the Authority's Bonds, plus accrued interest, at an interest rate that may be either fixed or subject to adjustment at varying periods, but in either case not to be in excess of 10.0% per annum at the time of initial issuance.





**Union Light, Heat and Power Company**  
**Detail of Estimated Construction and Acquisition Expenditures**  
**(807 KAR 5:001 Section 11 (1)(d))**

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>Total</u>
<b>Gas Department</b>				
Production	276,320	282,427	288,798	847,546
Special Projects	11,570,821	12,578,408	17,628,959	41,778,188
Distribution	10,922,641	11,342,012	12,672,650	34,937,303
Building & Grounds	298,988	305,414	345,336	949,738
Meters	1,379,812	3,283,915	4,210,094	8,873,820
<b>Total Gas Department</b>	<u>24,448,583</u>	<u>27,792,175</u>	<u>35,145,837</u>	<u>87,386,595</u>
<b>Electric Department</b>				
Substations - Transmission	2,485,446	816,091	-	3,301,537
Substations - Distribution	3,980,817	3,050,646	4,044,567	11,076,030
Transmission Lines	348,523	555,634	679,020	1,583,177
Distribution Transformers	1,242,868	1,258,332	1,292,697	3,793,896
Line Extensions	4,793,678	4,856,215	4,915,054	14,564,947
Street Lights	462,036	457,734	469,166	1,388,936
Generation - Acquisition	371,645,000	-	-	371,645,000
Generation - Construction	39,369,000	23,681,000	40,924,000	103,974,000
Distribution Improvements	5,693,519	6,313,164	5,581,208	17,587,892
Buildings & Grounds	240,622	243,616	276,740	760,977
Meters & Instrument Transform	693,765	3,435,981	4,537,878	8,667,624
Transportation	20,330	23,587	19,251	63,168
<b>Total Electric Department</b>	<u>430,975,603</u>	<u>44,692,000</u>	<u>62,739,581</u>	<u>538,407,184</u>
<b>Other Common Plant and Equipment</b>	<u>2,163,365</u>	<u>2,069,966</u>	<u>1,073,186</u>	<u>5,306,517</u>
<b>Total Construction and Acquisition Expense</b>	<u>457,587,551</u>	<u>74,554,141</u>	<u>98,958,604</u>	<u>631,100,296</u>



THE UNION LIGHT, HEAT AND POWER COMPANY

FINANCIAL EXHIBIT

September 30, 2004

807 KAR 5:001, SECTION 6

(1.) Amount and kinds of stock authorized.

1,000,000 shares of Capital Stock \$15 per share par value amounting to \$15,000,000 total par value.

(2.) Amount and kinds of stock issued and outstanding.

585,333 shares of Capital Stock \$15 per share par value amounting to \$8,779,995 total par value plus additional paid in capital thereon of \$23.541 million.

(3.) Terms of preference of preferred stock whether cumulative or participating, or on dividends or assets or otherwise.

There is no preferred stock authorized, issued or outstanding.

(4.) Brief description of each mortgage on property of applicant, giving date of execution, name of mortgagor, name of mortgagee, or trustee, amount of indebtedness authorized to be secured thereby, and the amount of indebtedness actually secured, together with any sinking fund provisions.

The Union Light, Heat and Power Company, as of February 1, 1949, executed its "First Mortgage" to The Bank of New York, Trustee, as security for the issuance of First Mortgage Bonds. As of October 1, 1951, it executed the "First Supplemental Indenture," as of May 1, 1954, the "Second Supplemental Indenture," as of July 1, 1959, the "Third Supplemental Indenture," as of July 1, 1963, the "Fourth Supplemental Indenture," as of June 1, 1970, the "Sixth Supplemental Indenture," as of October 1, 1973, the "Seventh Supplemental Indenture," as of December 1, 1978, the "Eighth Supplemental Indenture," as of December 15, 1981, the "Ninth Supplemental Indenture," as of July 1, 1989, the "Tenth Supplemental Indenture," as of June 1, 1990, the "Eleventh Supplemental Indenture," as of November 15, 1990, the "Twelfth Supplemental Indenture," and as of August 1, 1992, the "Thirteenth Supplemental Indenture," to said First Mortgage for the issuance of additional First Mortgage Bonds. The Company redeemed the First Mortgage Bonds issued under the First Supplemental Indenture on October 1, 1981, the Second Supplemental Indenture on May 1, 1984, the Third Supplemental Indenture on July 1, 1989, the Fourth Supplemental Indenture on July 1, 1993, the Sixth Supplemental Indenture on

September 30, 1977, the Seventh Supplemental Indenture on April 23 & 24, 1998, the Eighth Supplemental Indenture on May 1, 1996, the Ninth Supplemental Indenture on December 15, 1990, the Tenth Supplemental Indenture on September 1, 1995, the Eleventh Supplemental Indenture on June 1, 1995, the Twelfth Supplemental Indenture on February 15, 1996 and the Thirteenth Supplemental Indenture on August 1, 1999. The Company also executed a "Fifth Supplemental Indenture" as of January 1, 1967, changing certain provisions of the Mortgage. This mortgage, as amended, in the opinion of counsel for the Company, constitutes a direct first lien on all the property of the Company except rents, earnings, revenues, income or profit of the mortgaged property, cash, accounts receivable, supplies, etc. used in or held for the operation of the business. The aggregated principal amount of said Bonds at any time outstanding which may be secured by said First Mortgage presently is limited to \$200,000,000. As of September 30, 2004, the Company had issued and outstanding \$0 principal amount of First Mortgage Bonds secured under the terms of the Mortgage Indenture, as amended.

- (5.) Amount of bonds authorized, and amount issued, giving the name of the public utility which issued the same, describing each class separately, and giving date of issue, face value, rate of interest, date of maturity and how secured, together with amount of interest paid thereon during the last fiscal year.

The First Mortgage as amended, presently limits the principal amount of bonds which can be outstanding at any one time to \$200,000,000. The Company has outstanding First Mortgage Bonds, all of which are secured by the First Mortgage, as amended, of the Company to The Bank of New York, as Trustee, as follows:

<u>Indenture</u>	<u>Date of Issue</u>	<u>Principal Amount Auth. &amp; Issued</u>	<u>Rate of Interest</u>	<u>Date of Maturity</u>	<u>Interest Paid Year 2004</u>
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None Outstanding

The Company has outstanding Debentures issued under the Indenture dated as of July 1, 1995, between the Company and The Fifth Third Bank, as Trustee, as follows:

<u>Indenture</u>	<u>Date of Issue</u>	<u>Principal Amount Auth. &amp; Issued</u>	<u>Rate of Interest</u>	<u>Date of Maturity</u>	<u>Interest Paid Year 2004</u>
1st Supplement	7/25/95	\$ 15,000,000	7.65%	7/15/2025	\$1,147,500
2 <sup>nd</sup> Supplement	4/30/98	\$ 20,000,000	6.50%	4/30/2008	\$1,300,000
4 <sup>th</sup> Supplement	9/17/99	\$ 20,000,000	7.875%	9/15/2009	\$1,575,000

The Company has outstanding Debentures issued under the Indenture dated December 1, 2004 between the Company and Deutsche Bank trust Company Americas, as Trustee, as follows:

<u>Indenture</u>	<u>Date of Issue</u>	<u>Principal Amount Auth. &amp; Issued</u>	<u>Rate of Interest</u>	<u>Date of Maturity</u>	<u>Interest Paid Year 2004</u>
Indenture	12/9/04	\$40,000,000.00	5.00%	12/15/14	\$0.00

(6.) Each note outstanding, giving date of issue, amount, date of maturity, rate of interest, in whose favor, together with amount of interest paid thereon during the last fiscal year.

<u>Payee</u>	<u>Date of Issue</u>	<u>Amount</u>	<u>Date of Maturity</u>	<u>Rate of Interest</u>	<u>Interest Paid Year 2004</u>
Cinergy Corp	9/30/04	\$26,140,351	10/01/04	1.86%	-
Cinergy Services	9/30/04	\$10,754,523	10/30/04	1.75%	-

(7.) Other indebtedness, giving same by classes and describing security, if any, with a brief statement of the devolution or assumption of any portion of such indebtedness upon or by person or corporation if the original liability has been transferred, together with amount of interest paid thereon during the last fiscal year.

To the extent that capital leases are considered debt, there are \$7.314 million in current and non-current capital lease obligations at September 30, 2004.

(8.) Rate and amount of dividends paid during the five (5) previous fiscal years, and the amount of capital stock on which dividends were paid each year.

<u>Year Ending</u>	<u>Dividends Paid</u>		<u>No. of Shares</u>	<u>Par Value of Stock</u>
	<u>Per Share</u>	<u>Total (\$000)s</u>		
December 31, 1999	16.50	9,658	585,333	8,779,995
December 31, 2000	16.50	9,658	585,333	8,779,995
December 31, 2001	20.00	11,707	585,333	8,779,955
December 31, 2002	16.52	9,670	585,333	8,779,955
December 31, 2003	10.77	6,305	585,333	8,779,955

(9.) Detailed Income Statement and Balance Sheet.

See attached pages 4 through 7 of Financial Exhibit for detailed income statement for the twelve months ended September 30, 2004 and detailed balance sheet as of September 30, 2004.

THE UNION LIGHT, HEAT AND POWER COMPANY

NOTE TO FINANCIAL STATEMENTS

September 30, 2004

1. Utility plant is stated at original cost which does not represent its present day replacement or realizable value. The Kentucky statutes expressly authorize the Kentucky Public Service Commission to ascertain, for rate making purposes, the value of the property of any public utility and provide that, in making any such valuation, the Commission shall give due consideration to the history and development of the utility and its property, original cost, cost of reproduction as a going concern, and other elements of value recognized by the law of the land for rate making purposes.

THE UNION LIGHT, HEAT AND POWER COMPANY

Balance Sheet at September 30, 2004

Assets  
(Dollars in Thousands)

**Current Assets**

Cash and cash equivalents	\$7,699
Notes receivable, current	5,301
Accounts receivable less accumulated provision for doubtful accounts of \$17 at September 30, 2004,	1,937
Accounts receivable from affiliated companies	169
Fuel and supplies	10,789
Prepayments and other	427
Total current assets	<u>26,322</u>

**Property, Plant, and Equipment - at Cost**

Utility Plant in Service	
Electric	283,525
Gas	251,354
Common	53,551
Total Utility Plant in Service	<u>588,430</u>
Construction work in progress	6,887
Total Utility Plant	<u>595,317</u>
Accumulated depreciation	<u>186,142</u>
Net Property, Plant, and Equipment	409,175

**Other Assets**

Regulatory assets	13,182
Other	716
Total other assets	<u>13,898</u>

**Total Assets** \$449,395

THE UNION LIGHT, HEAT AND POWER COMPANY

Balance Sheet at September 30, 2004

Liabilities  
(Dollars in Thousands)

**Current Liabilities**

Accounts payable	\$3,145
Accounts payable to affiliated companies	18,701
Accrued taxes	5,804
Accrued interest	997
Notes payable to affiliated companies	36,895
Other	6,738
Total Current Liabilities	<u>72,280</u>

**Non-Current Liabilities**

Long-term debt	54,708
Deferred income taxes	59,546
Unamortized investment tax credits	2,687
Accrued pension and other postretirement benefit costs	14,829
Accrued cost of removal	29,029
Other	13,681
Total Non-Current Liabilities	<u>174,480</u>

Total Liabilities 246,760

**Common Stock Equity**

Common stock-\$15.00 par value; authorized shares- 1,000,000; outstanding shares-- 585,333	8,780
Paid-in capital	23,541
Retained earnings	170,803
Accumulated other comprehensive loss	(489)
Total Common Stock Equity	<u>202,635</u>

**Total Liabilities and Shareholders' Equity \$449,395**



THE UNION LIGHT, HEAT AND POWER COMPANY

Income Statement

For The Twelve Months Ended September 30, 2004  
(Dollars in Thousands)

**Operating Revenues**

Electric	\$228,555
Gas	120,308
<b>Total Operating Revenues</b>	<u>348,863</u>

**Operating Expenses**

Electricity purchased from parent company for resale	158,535
Gas purchased	76,732
Operation and maintenance	55,084
Depreciation	19,677
Taxes other than income taxes	3,105
<b>Total Operating Expenses</b>	<u>313,133</u>

**Operating Income** 35,730

**Miscellaneous Income – Net** 1,330

**Interest Expense** 5,367

**Income Before Taxes** 31,693

**Income Taxes** 10,862

**Net Income** \$20,831



Cinergy Services, Inc.  
139 East Fourth Street, Rm 25 AT II  
P.O. Box 960  
Cincinnati, OH 45201-0960  
tel 513.287.3842  
fax 513.287.2996  
aschafer@cinergy.com

Anita M. Schafer  
Paralegal

**VIA OVERNIGHT MAIL**

January 11, 2005

**RECEIVED**

JAN 12 2005

PUBLIC SERVICE  
COMMISSION

Ms. Elizabeth O'Donnell  
Executive Director  
Kentucky Public Service Commission  
211 Sower Boulevard  
Frankfort, KY 40602

Case 2005-00027

Dear Ms. O'Donnell:

Enclosed please find an original and fourteen copies of the Application of The Union Light Heat and Power Company. Please date-stamp the four extra copies and return to me in the overnight envelope provided.

Should you have any further questions, please do not hesitate to call me.

Very truly yours,

Anita M. Schafer  
Paralegal

AMS/mak

Enclosures

cc: Elizabeth Blackford



COMMONWEALTH OF KENTUCKY

RECEIVED

BEFORE THE PUBLIC SERVICE COMMISSION

MAR 07 2005

PUBLIC SERVICE COMMISSION

In the Matter of the Application of The Union )  
Light, Heat and Power Company for an Order )  
Authorizing the Issuance of First Mortgage )  
Bonds, Unsecured Debt, and Long Term Notes, )  
Issuance of Inter-Company Promissory Notes, )  
Execution and Delivery of Long-Term Loan )  
Agreements, and Use of Interest Rate )  
Management Instruments. )

Case No. 2005-00027

AMENDED APPLICATION

The Union Light, Heat and Power Company (ULH&P) submits this Amended Application, requesting the Kentucky Public Service Commission (Commission), pursuant to KRS 278.300 and 807 KAR 5:001 Section 11, to authorize a financing program that includes, in addition to the financing authority requested in ULH&P's January 12, 2005 Application in this proceeding, the assumption by ULH&P of debt of The Cincinnati Gas & Electric Company (CG&E)<sup>1</sup>. ULH&P has determined that management and mitigation of certain tax issues may be facilitated by the assumption of certain CG&E debt rather than the issuance of inter-company notes or debt. Therefore, ULH&P respectfully amends its Application<sup>2</sup> to petition the Commission to authorize a financing program that includes the issuance of debt securities, execution, delivery or assumption of various loan agreements related to the issuance of tax-exempt bonds,

<sup>1</sup> The original Application requested authority for ULH&P to assume tax exempt debt associated with the assets to be transferred to ULH&P. This Amended Application requests the additional flexibility for ULH&P to assume debt of CG&E in connection with the Generation Acquisition without regard to whether the debt is taxable or tax-exempt.

<sup>2</sup> ULH&P replicates below the requested relief from its Application, highlighting in bold italics the changes related to the assumption of debt.

issuance of inter-company unsecured promissory notes and/or assumption of debt owed by CG&E, the use of interest rate management instruments, and entrance into all necessary agreements and other documents relating thereto for the purpose of acquiring certain generating assets as approved by the Commission in Case No. 2003-00252<sup>3</sup> (Generation Acquisition), and for other general lawful purposes arising from the ongoing general financing needs of ULH&P, as more fully described herein. Further, ULH&P requests expedited treatment of this Amended Application, as further described herein. In support of this Amended Application, ULH&P states as follows:

1. **Address:** ULH&P is a Kentucky corporation with its principal office and principal place of business at 1697A Monmouth Street, Newport Shopping Center, Newport, Kentucky 41071. The address of ULH&P's principal executive office is 139 East Fourth Street, Cincinnati, Ohio 45202.

2. **Articles of Incorporation:** Pursuant to 807 KAR 5:001, Section 8(3), ULH&P states that a certified copy of its Articles of Incorporation, as amended, is on file with the Commission in Case No. 6566.

3. **Statement of Business:** ULH&P is a utility as defined in KRS 278.010(3)(a) and (b), engaged in providing retail gas and electric services to its customers in Northern Kentucky in various municipalities and unincorporated areas of Kenton, Campbell, Boone, Gallatin, Grant, and Pendleton Counties. ULH&P is thus subject to the jurisdiction of the Commission.

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<sup>3</sup> See *In the Matter of the Application of the Union Light, Heat and Power Company for a Certificate of Public Convenience to Acquire Certain Generation Resources and Related Property; for Approval of Certain Purchase Power Agreements; for Approval of Certain Accounting Treatment; and for Approval of Deviation from Requirements of KRS 278.2207 and 278.2213(6)*, Case No. 2003-00252 (Order issued December 5, 2003).

4. **Acquisition of Generation.** As described in Case No. 2003-00252, ULH&P plans to acquire an ownership interest in three electric generating facilities from its parent company, CG&E. These facilities include the East Bend Generating Station, Miami Fort Generating Station Unit 6, and the Woodsdale Generating Station (Plants). In testimony filed in Case No. 2003-00252, ULH&P described its plans to finance the Generation Acquisition to achieve a capital structure that supports a strong investment-grade credit rating, and stated that it would endeavor to achieve and maintain a structure consisting of approximately 50% debt and 50% equity.<sup>4</sup> ULH&P again submits that this target capital structure is reasonable considering ULH&P's evolution into a fully integrated electric utility provider. The financing instruments described herein are intended, in part, to finance the Generation Acquisition.

Additionally, the financing instruments described herein are designed to provide ULH&P the flexibility it needs on a going-forward basis to finance its operations and capital projects and maintain, as a fully integrated electric utility owning generating stations, strong investment-grade credit ratings well after the Generation Acquisition is closed.

5. **807 KAR 5:001 Section 11 (1) (a).** As of September 30, 2004, the net cost of the property, plant and equipment of ULH&P was \$409.2 million. Its principal properties consist of electric and gas distribution facilities. With the acquisition of generating assets from CG&E, ULH&P expects to add property on April 1, 2005 of approximately \$371.6 million thereby increasing its net cost of property, plant and equipment to approximately \$781 million.

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<sup>4</sup> See Case No. 2003-00252, Direct Testimony of Gregory C. Ficke at 16 - 17.

6. **807 KAR 5:001 Section 11 (1) (b).** ULH&P proposes, and requests the Commission's approval of, a financing program permitting ULH&P to:

(a) issue and sell, from time to time over a period ending December 31, 2006, up to \$500 million principal amount of first mortgage bonds (the "Bonds"), senior or junior unsecured indebtedness (the "Debentures", and together with the Bonds, the "Securities"), or unregistered unsecured long-term notes (the "Long-Term Notes"), in any combination thereof and in one or more series, provided the aggregate of all such securities shall not exceed \$500 million;

(b) issue at closing a long-term unsecured inter-company promissory note or notes (the "Inter-Company Promissory Notes"), *or assume debt of CG&E, as the transferor of the generating assets*, up to an aggregate principal amount of \$200 million, as partial payment of the Generation Acquisition;

(c) execute and deliver and/or assume, from time to time over a period ending December 31, 2006, one or more long-term loan agreements (the "Loan Agreements") by which ULH&P would borrow from authorized issuers of tax-exempt bonds (the "Authority"), for terms not to exceed 40 years, the proceeds of up to a maximum of \$200 million aggregate principal amount of the Authority's tax exempt bonds that may be issued in one or more series (the "Authority's Bonds"); and

(d) enter into Interest Rate Management Instruments to manage interest costs on its financial obligations (the "Interest Rate Management Instruments").

The authority ULH&P seeks herein is intended to replace in its entirety the financing authority granted in Case No. 2004-00435.

## SECURITIES

a. Method of Issuance. ULH&P proposes to either (i) sell the Securities to one or more purchasers or underwriters through negotiated offerings or (ii) sell the Securities through a competitive bidding process. In the event the Securities are sold through a negotiated offering, the terms of each offering of the Securities will be negotiated by ULH&P either with one or more underwriters, or with one or more purchasers for a direct sale or for a sale through agents. If the Securities are sold through competitive bidding, the Securities will be sold to the bidder(s) whose proposal results in the lowest annual cost of money, with ULH&P having the right to reject any or all bids. Each of the bidders will be required to specify the coupon rate and the price, exclusive of accrued interest, to be paid for the Securities. Subject to approval of the terms for each offering by ULH&P's Board of Directors or by persons authorized by ULH&P's Board of Directors, it is anticipated that an agreement and other transaction documents setting forth the terms and conditions for issuance and sale of the Securities would be concluded.

b. Pricing Parameters. ULH&P has developed parameters under which the Securities are to be sold. The parameters, as set forth in Exhibit A, are designed to provide a reasonable allowance for potential changes in financial market conditions between the time of Commission authorization and the actual sale of the Securities. The inclusion of the parameters within the Order would allow ULH&P to sell the Securities on any day when it believes it is prudent to do so, provided the terms are within the parameters.

c. Security and Other Agreements. The Bonds will be issued under and secured by a first mortgage, either the first mortgage dated as of February 1, 1949



between ULH&P and The Bank of New York, Trustee, as amended and supplemented to date and as proposed to be supplemented by one or more supplemental indentures (“First Mortgage”), or a new first mortgage agreement with a trustee to be determined. If the Debentures are issued, they will be issued under an indenture, either the Indenture dated as of December 1, 2004, between ULH&P and Deutsche Bank Trust Company Americas, as Trustee, or its successor, as supplemented by one or more supplemental indentures, or a new indenture with a trustee to be determined.

d. Accounting. ULH&P proposes either to credit premiums or charge discounts, if any, and to charge the expenses to be incurred in connection with each issue to the proper deferred accounts and amortize to current income such amounts over the respective lives of the Securities in equal annual amounts.

#### **LONG-TERM NOTES**

a. Method of Borrowing. ULH&P proposes entering into one or more unsecured Long-Term Notes having a maturity date not less than 2 years and which may bear interest at either a fixed or variable rate. The obligation shall be evidenced by execution of a long-term note and a loan agreement or similar document under terms mutually agreeable to ULH&P and the lender and in conformity with generally accepted market conventions.

b. Pricing Parameters. The Long-Term Notes will be issued under terms and conditions similar to the Debentures, except that the Long-Term Notes would typically be negotiated directly with one or more banks or other financial institutions, with less formality than is typical of the issuance and sale of a Debenture.

c. Accounting. ULH&P proposes to charge the expenses to be incurred in connection with each Long-Term Note to the proper deferred accounts and amortize to current income such amounts over the respective lives of the Long-Term Notes in equal annual amounts.

**INTER-COMPANY PROMISSORY NOTES OR ASSUMPTION OF DEBT**

ULH&P proposes to issue one or more Inter-Company Promissory Notes to CG&E *or to assume certain indebtedness of CG&E* in connection with the Generation Acquisition and from time to time as it deems necessary and appropriate as the most economical form of financing. With regard to the Generation Acquisition, the Inter-Company Promissory Notes will be issued for a portion of the net book value of the generating assets, along with inventories, supplies and transaction costs at the time of closing of the purchase transaction, including amounts reflecting tax exempt debt related to assets to be owned by ULH&P, but in no case shall the Inter-Company Promissory Notes exceed an aggregate value of \$200 million. A portion of the Inter-Company Promissory Notes related to specific projects at East Bend Generating Station that qualified for tax-exempt financing will bear an interest rate per annum equal to the all-in weighted average cost of the specific underlying tax-exempt issuances applicable to East Bend Generating Station, with all-in cost to include the coupon interest rate plus any additional costs associated with amortization of financing charges and debt discounts associated with the tax exempt issuances. All other Inter-Company Promissory Notes will bear an interest rate per annum equal to the all-in weighted average cost of imbedded long-term debt (excluding tax exempt debt) of CG&E, with all-in cost to include the coupon interest rate plus any additional costs associated with amortization of financing

charges and debt discounts associated with outstanding issuances of CG&E. The Promissory Note or Notes related to the Generation Acquisition will mature on or before December 31, 2039, and will be prepayable at the option of ULH&P, in whole or in part, at any time before the scheduled maturity, without penalty or premium.

*As an alternative to or in combination with the issuance of Inter-Company Promissory Notes in connection with the Generation Acquisition, ULH&P requests authority to assume indebtedness of CG&E. In the case of assumption of debt, ULH&P would become responsible for payment of principal and interest and the other obligations set forth in the loan documentation of the debt assumed. The interest rate for any debt assumed by ULH&P would not exceed the all-in weighted average cost of the debt assumed, with all-in cost to include the coupon interest rate plus any additional costs associated with the debt assumption and amortization of financing charges and debt discounts associated with the debt assumed.*

With regard to the Generation Acquisition, by issuing a Promissory Note or Notes to CG&E *or assuming indebtedness of CG&E*, ULH&P will be able to avoid having to go to the capital markets for financing the acquisition of the generating assets immediately after receiving all necessary approvals. ULH&P will have a period of time to arrange for permanent financing for the generating assets and will be able to retire the Inter-Company Promissory Notes prior to maturity at par if more advantageous financing becomes available. Today's market could not provide equivalent financing (with the same timing flexibility, no prepayment penalty, and subordinate to all other senior debt) at a cost below the cost of the Inter-Company Promissory Notes. A form of the promissory note is attached as Exhibit B.

## LOAN AGREEMENTS

ULH&P proposes to borrow from various Authorities the proceeds from the issuance by such Authorities of tax exempt bonds. ULH&P will enter into one or more Loan Agreements with the respective Authority to evidence and secure its obligations to repay such loans. ULH&P will use the proceeds from the loans to finance or reimburse the costs of acquiring and constructing certain solid waste facilities and other environmental-control facilities. ULH&P also proposes to assume responsibility for certain existing tax exempt debt under Loan Agreements between CG&E and the respective Authority to the extent any such indebtedness was incurred to finance any part of the Generating Assets being transferred to ULH&P.

a. ULH&P's Loan Obligations. ULH&P's obligations under each Loan Agreement will be to provide the Authority with sufficient revenues to enable it to pay all of the principal of, premium, if any, and interest on, the Authority's Bonds as and when any and all payments are due. ULH&P may procure bond insurance or a letter of credit to provide credit support for its payment obligations and/or ULH&P may issue First Mortgage Bonds to secure ULH&P's obligations under each individual Loan Agreement or as security for ULH&P's reimbursement obligations under the bond insurance agreements. Alternatively, ULH&P's payment obligations under the Loan Agreements may be unsecured. First Mortgage Bonds may be in principal amounts equal to the aggregate principal amounts of the Authority's Bonds to which they relate (in which case they may provide for the payment of interest at the rate borne by the Authority's Bonds). Each Loan Agreement will stand alone, allowing ULH&P the option of securing or not securing its obligations under each Loan Agreement.

b. The Authority's Bonds. The Authority's Bonds have been (in the case of assumption of existing payment obligations) or will be issued pursuant to one or more Indentures of Trust (the "Indentures") to be entered into between the Authority and a trustee to be determined, which Indentures establish the terms of each series of the Authority's Bonds. The Authority's Bonds will be special obligations payable solely out of revenues derived from the payments by ULH&P under the respective Loan Agreements.

The Authority's Bonds or any series thereof may be entitled to the benefits of one or more letters of credit, may be entitled to the benefit of one or more bond insurance policies, or may be issued without the benefit of such letters of credit or insurance policies.

If a letter of credit is obtained, ULH&P would enter into a reimbursement agreement with a qualified financial institution issuing the letter of credit. Such reimbursement agreements would require ULH&P to reimburse the financial institutions for all drawings made under the letter of credit and to pay annual fees not in excess of one and one-half percent (1-1/2%) of the amount available under the letter of credit. The existence of a letter of credit securing payment of the Loan Agreements from a highly rated financial institution would be expected to allow the sale of the Authority's Bonds with a lower interest rate than would exist without such a letter of credit.

Likewise, if bond insurance is obtained from a highly rated insurance company, the Authority's Bonds would be rated in a higher rating category than ULH&P's First Mortgage Bonds or Debentures by credit rating agencies and therefore would be expected to have a lower interest rate.

It is expected that bond counsel will render its opinion that, under existing laws, including regulations and official rulings by the Internal Revenue Service, interest on the Authority's Bonds will be excluded from gross income of the recipient thereof for federal income tax purposes, except for interest on any bond held by a substantial user or a related person as those terms are used in Section 147(a) of the Internal Revenue Code of 1986 as amended. Therefore, ULH&P expects the interest rate on the Authority's Bonds will be less than the interest rate ULH&P would be able to obtain on taxable bonds that ULH&P could issue with similar terms and conditions in the capital markets.

The terms of each offering of the Authority's Bonds will be negotiated by ULH&P with underwriters. After approval of the terms by ULH&P's Board of Directors and the Authority, ULH&P proposes to arrange for the sale of each series of the Authority's Bonds to the underwriters pursuant to one or more bond purchase agreements between the Authority and the underwriters, and pursuant to one or more representation letters from ULH&P to the Authority and the underwriters.

c. Pricing Parameters. ULH&P has developed parameters under which the Loan Agreements are to be executed, as set forth in Exhibit C. The inclusion of these parameters within the Order would allow ULH&P to execute and deliver the Loan Agreements and any reimbursement or insurance agreements prior to the time ULH&P and the underwriters reach agreement with respect to the terms of the Authority's Bonds. If a series of the Authority's Bonds bears interest at a rate that is subject to adjustment, the same will also contain a feature that will allow the interest rate to become fixed under certain circumstances. ULH&P proposes the Commission include such limits in its order.

d. Assumption of Tax-Exempt Debt. ULH&P proposes the assumption of certain tax-exempt related obligations of CG&E in connection with the acquisition of generation assets from CG&E. These obligations of CG&E are evidenced by a Loan Agreement between CG&E and the Authority which obligations shall, through assignment, assumption or other agreement, become the obligations of ULH&P, which shall become responsible for payment of all associated interest, principal and related amortized expenses and discounts either directly to the trustee or by reimbursing CG&E. ULH&P may from time to time and subject to the Commission authority above, elect to issue the Authority's Bonds subject to a new Loan Agreement between ULH&P and the Authority directly and in place of CG&E. At such time, the Authority's Bonds shall become special obligations of ULH&P.

#### **INTEREST RATE MANAGEMENT INSTRUMENTS**

a. General. ULH&P requests that this Commission grant it authority to enter into Interest Rate Management Instruments to manage its overall effective interest cost. Such authority will allow ULH&P sufficient alternatives and flexibility when striving to better manage its interest cost. Such authority was previously granted in Case No. 2001-00439.

b. Description of the Interest Rate Management Instruments. The Interest Rate Management Instruments will facilitate products commonly used in today's capital markets, consisting of interest rate swaps, caps, collars, floors, options, or hedging products such as forwards or futures, or similar products, the purpose of which being to manage interest costs. ULH&P expects to enter into Interest Rate Management Instruments with counterparties that are highly rated financial institutions. The

transactions will be for a fixed period and a stated principal amount, and may be for underlying fixed or variable interest rate obligations of ULH&P.

c. Pricing Parameters. ULH&P proposes that the pricing parameters for Interest Rate Management Instruments be governed by the parameters corresponding to the underlying obligation in effect at its original issuance as specified in the Order authorizing such obligation by this Commission, if applicable.

Net fees and commissions in connection with any interest rate management agreement will be in addition to the above parameters and will not exceed 10% of the amount of the underlying obligation involved.

d. Accounting. ULH&P proposes to account for these transactions in accordance with generally accepted accounting principles.

e. Commission Authorization. Since market opportunities for these interest rate management alternatives are transitory, ULH&P must be able to execute interest rate management transactions when the opportunity arises to obtain the most competitive pricing. Thus, ULH&P seeks approval to enter into any or all of the described transactions within the parameters discussed above prior to the time ULH&P reaches agreement with respect to the terms of such transactions.

The authorization of the Interest Rate Management Instruments consistent with the parameters herein in no way relieves ULH&P of its responsibility to obtain the best terms available for the product selected and, therefore, it is appropriate and reasonable for this Commission to authorize ULH&P to agree to such terms and prices consistent with said parameters.



## CONTRIBUTION OF CAPITAL

ULH&P anticipates receiving from CG&E contributed capital in connection with ULH&P's acquisition of generating assets from CG&E and from time to time to support a capitalization ratio at ULH&P that is compatible with and supports the ratings of a financially strong fully integrated electric utility. After approval of the terms for each receipt of contributed capital by ULH&P's Board of Directors or by persons authorized by ULH&P's Board of Directors, it is anticipated that, to the extent necessary, an agreement and other transaction documents setting forth the terms of the contributed capital would be concluded.

7. **807 KAR 5:001 Section 11 (1) (c).** The proceeds from the Securities, Long-Term Notes, Inter-Company Promissory Notes, Loan Agreements *and debt assumptions*, are expected to be used *for one or more of the following*: (i) to repay a portion of ULH&P's short-term indebtedness; (ii) to redeem early long-term debt of ULH&P, if market conditions are favorable; (iii) to fund estimated future construction expenditures related to its gas delivery and electric generation, transmission and distribution businesses of \$86 million in 2005 and \$75 million in 2006;<sup>5</sup> (iv) for acquisition of generating assets from CG&E along with inventory and supplies and transaction costs; (v) for such additional expenditures as contemplated by KRS 278.300; and/or (vi) for other lawful corporate purposes. The financing authority requested herein is necessary and appropriate for and consistent with the proper performance by ULH&P of its services to the public, will not impair its ability to perform those services, and is reasonably necessary and appropriate for such purposes.

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<sup>5</sup> These construction cost estimates do not include expenditures related to generating asset acquisition. Financing with respect to such expenditures will be addressed in a future filing.

8. **807 KAR 5:001 Section 11 (1) (d).** See Exhibit D concerning estimated construction expenditures, attached hereto, and made a part hereof.

9. **807 KAR 5:001 Section 11 (1) (e).** The short-term indebtedness expected to be discharged or partially discharged with the proceeds from the sale of the Securities consists primarily of short-term inter-company borrowings.

10. In Case No. 2001-00439 the Commission approved the issuance and sale of up to \$75,000,000 principal amount of First Mortgage Bonds or unsecured debt and the use of Interest Rate Management Instruments for the period ending December 31, 2004. As of the date of this filing, ULH&P has issued \$40,000,000 in unsecured indentures under this previous authority. Further, in Case No. 2003-00435, ULH&P requested that the Commission approve the issuance and sale of up to \$75,000,000 principal amount of First Mortgage Bonds or unsecured debt and the use of Interest Rate Management Instruments for the period ending December 31, 2006 – such application was granted by order dated December 17, 2004. The authority ULH&P seeks in this proceeding is intended to fully replace in its entirety the authority granted in Case No. 2004-00435.

11. **807 KAR 5:001 Section 6 and Section 11 (2) (a).** ULH&P is filing the following information in Exhibit E, which is incorporated herein and made a part of this application:

<b><u>Exhibit E</u></b> <b>Page</b>	<b><u>Description</u></b>	<b><u>807 KAR 5:001</u></b> <b>Section Reference</b>
	Financial Exhibit	6 and 11 (2) (a)
1	Amount and kinds of stock authorized	6 (1)

1	Amount and kinds of stock issued and outstanding	6 (2)
1	Terms of preference or preferred stock	6(3)
1	Brief description of each mortgage on property of ULH&P	6 (4)
2	Amount of bonds authorized and issued and related information	6 (5)
3	Notes outstanding and related information	6 (6)
3	Other indebtedness and related information	6 (7)
3	Dividend information	6 (8)
3-7	Detailed Income Statement and Balance Sheet	6 (9)

12. **807 KAR 5:001 Section 11 (2) (b).** The requested deeds of trust or mortgage documents indicated were filed in the following proceedings:

<u>Document</u>	<u>Style of Case</u>	<u>Case No.</u>	<u>Ex. No.</u>
First Mortgage February 1, 1949	In the Matter of the Application of The Union Light, Heat and Power Company for an Order Authorizing Issue of Capital Stock and First Mortgage Bonds	1797	5
First Supplemental Indenture	In the Matter of the Application of The Union Light, Heat and Power Company for an Order Authorizing a Ten-for-One Capital Stock Split, Changing Par Value from \$100 to \$15 per share Thereof and Transfer from Earned Surplus Account to Capital Stock Account the Sum Of \$1,247,904.26	2569	4
Second Supplemental Indenture May 1, 1954	In the Matter of the Application of The Union Light, Heat and Power Company for an Order Authorizing Issue of Additional Capital Stock	2896	3

Third Supplemental Indenture July 1, 1959	In the Matter of the Application of The Union Light, Heat and Power Company for an Order Authorizing Issue of Additional Capital Stock	3976	3
Fourth Supplemental Indenture July 1, 1963	In the Matter of the Application of The Union Light, Heat and Power Company for Authority to Issue up to \$6,000,000 of Short-term Bank Loans with no Maturity To Exceed 25 months	5085	3
Fifth Supplemental Indenture January 1, 1967	In the Matter of the Application of The Union Light, Heat and Power Company for Authority to Issue up to \$6,000,000 of Short-term Bank Loans with no Maturity to Exceed 25 months	5085	4
Sixth Supplemental Indenture June 1, 1970	In the Matter of the Application of The Union Light, Heat and Power Company for Authority to Issue up to \$5,000,000 of Short-term Bank Loans with no Maturity to Exceed 25 months	5567	3
Seventh Supplemental Indenture October 1, 1973	In the Matter of the Application of The Union Light, Heat and Power Company for Order Authorizing Issue of \$10,000,000 First Mortgage Bonds, Series Due 2003	7270	E
Eighth Supplemental Indenture December 1, 1978	In the Matter of the Application of The Union Light, Heat and Power Company for Order Authorizing Issue of \$10,000,000 First Mortgage Bonds, Series Due 2008	8387	C
Ninth Supplemental Indenture December 15, 1981	In the Matter of the Application of The Union Light, Heat and Power Company for Order Authorizing Issue and Sale of up to \$35,000,000 Principal Amount of First Mortgage Bonds	89-120	C
Tenth Supplemental Indenture July 1, 1989	In the Matter of the Application of The Union Light, Heat and Power Company for Order Authorizing Issue and Sale of up to \$55,000,000 Principal Amount of First Mortgage Bonds	90-295	C
Eleventh Supplemental Indenture	In the Matter of the Application of The Union Light, Heat and Power Company for Order Authorizing Issue and Sale of up to \$55,000,000	90-295	D

June 1, 1990	Principal Amount of First Mortgage Bonds		
Twelfth Supplemental Indenture November 15, 1990	In the Matter of the Application of The Union Light, Heat and Power Company for Order Authorizing Issue of Capital Stock	92-418	B
Thirteenth Supplemental Indenture August 1, 1992	In the Matter of the Application of The Union Light, Heat and Power Company for Order Authorizing Issue of Capital Stock	92-418	C
Indenture December 1, 2004	In the Matter of the Application of The Union Light, Heat and Power Company for an Order Authorizing the (i) Issuance and Sale of up to \$75,000,000 Principal Amount of First Mortgage Bonds or Unsecured Debt and (ii) Use of Interest Rate Management Techniques	2001-00439	

13. **807 KAR 5:001 Section 11 (2) (c).** The proposed construction is primarily comprised of installations, improvements and extensions in the ordinary course of business. It is therefore impractical to submit maps and plans pertaining thereto. To the extent maps of the generating assets ULH&P intends to acquire from CG&E are necessary, ULH&P refers the Commission to those maps provided in Case No. 2003-00252.<sup>6</sup>

14. **Expedited Treatment.** KRS 278.300 provides that:

Every such [financing] application shall be placed at the head of the docket of the commission and disposed of promptly within sixty (60) days after it is filed with the commission, unless it is necessary for good cause to continue the application for longer time than sixty (60) days, in which case the order making the continuance shall state fully the facts that make it necessary.

ULH&P requests that the Commission expedite its approval of ULH&P's Amended Application so as not to unduly delay the closing of the Generation Acquisition. ULH&P's current targeted effective closing date is May 1, 2005. Should the

<sup>6</sup> See Burns & McDonnell Due Diligence Evaluations filed in Case No. 2003-00252, July 21, 2003.

Commission use the entirety of its sixty-day review period, ULH&P will certainly have to further delay the closing of the Generation Acquisition. Given that ULH&P's amendment to its previously-filed Application is minor in nature, resulting in no effect on ULH&P's books (ULH&P will simply owe debt payments to a third-party creditor rather than CG&E), ULH&P's request for expedited treatment is reasonable. ULH&P therefore requests that the Commission rule on this Amended Application by no later than April 15, 2005.

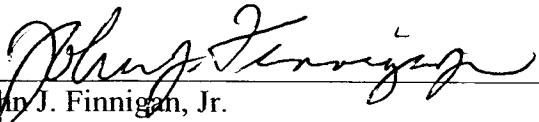
WHEREFORE, ULH&P asks that the Public Service Commission of the Commonwealth of Kentucky issue an order no later than April 15, 2005, authorizing ULH&P to issue and sell up to \$900 million principal amount of its Securities, Long-Term Notes, Inter-Company Promissory Notes *and/or conclude debt assumption agreements*, Loan Agreements, or any combination thereof, and to utilize Interest Rate Management Instruments, for the purposes herein stated and in a manner as herein set forth, and authorizing ULH&P to account for such Securities, Long-Term Notes, Inter-Company Promissory Notes, *debt assumption agreements*, Loan Agreements, and Interest Rate Management Instruments in the manner as herein set forth.

Dated at Cincinnati, Ohio, this 4<sup>th</sup> day of March, 2005.

THE UNION LIGHT, HEAT AND POWER COMPANY

By: Wendy L. Aumiller  
Wendy L. Aumiller  
Treasurer

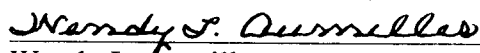
Its Attorneys:

  
 \_\_\_\_\_  
 John J. Finnigan, Jr.  
 Michael J. Pahutski  
 The Union Light, Heat and Power Company  
 139 East Fourth Street (EA025)  
 P.O. Box 960  
 Cincinnati, Ohio 45201

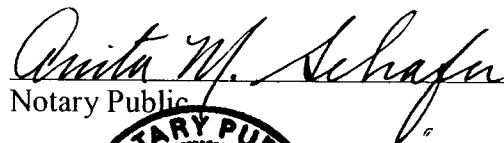
VERIFICATION

State of Ohio            )  
                                   )   SS:  
 County of Hamilton    )

Wendy L. Aumiller, being first duly sworn, deposes and says that she is Treasurer of ULH&P in the proceeding entitled above; that she has read the foregoing application and knows the contents thereof; and that the same is true of her own knowledge, except as to matters which are therein stated on information or belief, and that as to those matters she believes them to be true.

  
 \_\_\_\_\_  
 Wendy L. Aumiller

Subscribed and sworn to before me, this 4<sup>th</sup> day of March, 2005.


  
 \_\_\_\_\_  
 Notary Public



**ANITA M. SCHAFER**  
 Notary Public, State of Ohio  
 My Commission Expires  
 November 4, 2009

CERTIFICATE OF SERVICE

I hereby give notice that on this 4<sup>th</sup> day of March, 2005, a copy of the foregoing Amended Application was served on the following party by regular U.S. mail, postage prepaid, or overnight mail delivery.

  
\_\_\_\_\_  
John V. Finnigan, Jr.

Elizabeth E. Blackford  
Assistant Attorney General  
Office of Rate Intervention  
1024 Capital Center Drive, Suite 200  
Frankfort, KY 40601





**The Union Light, Heat and Power Company**

**Summary of Securities Pricing Parameters**

<b>Principal Amount:</b>	Up to \$500 million of first mortgage bonds (the “Bonds”) or unsecured indebtedness (the “Debentures”), or any combination thereof, in one or more series.
<b>Maturity:</b>	Up to 40 years.
<b>Purpose:</b>	To refund outstanding obligations, for construction expenditures, or for other general purposes.
<b>Lead Underwriters:</b>	To be named.
<b>Underwriting Commissions or Agents’ Fees:</b>	Not to exceed 3.50% of the principal amount.
<b>Price to Public:</b>	No higher than 102% nor less than 98% of the principal amount, plus accrued interest, if any.
<b>Interest Rate:</b>	Not to exceed those generally obtainable at the time of pricing or re-pricing of such Bonds and Debentures for securities having the same or reasonably similar maturities and having reasonably similar terms, conditions and features issued by utility companies or utility holding companies of the same or reasonably comparable credit quality.



No. \_\_\_\_\_

\$ \_\_\_\_\_

UNION LIGHT HEAT & POWER COMPANY  
\_\_\_\_% SUBORDINATED NOTE  
DUE \_\_\_\_\_

UNION LIGHT, HEAT & POWER COMPANY, a corporation duly organized and existing under the laws of the state of Kentucky (herein called the "Company"), for value received, hereby promises to pay to \_\_\_\_\_, or registered assigns, the principal sum of \_\_\_\_\_ Dollars on \_\_\_\_\_, and to pay interest thereon from \_\_\_\_\_ or from the most recent interest payment date to which interest has been paid or duly provided for, semiannually on \_\_\_\_\_ and \_\_\_\_\_ in each year, commencing \_\_\_\_\_, at the rate of \_\_\_\_% per annum, until the principal hereof is paid or made available for payment.

Payment of the principal of and interest on this Note will be made at the office or agency of the Company maintained for that purpose in Cincinnati, Ohio, in such coin or currency of the United States of America as at the time of payment is legal tender for payment of public and private debts; provided, however, that at the option of the Company payment of interest may be made by check.

Interest on this Note shall be computed on the basis of a 360-day year of twelve 30-day months.

Any payment on this Note due on any day which is not a Business Day in the City of Cincinnati, Ohio need not be made on such day, but may be made on the next succeeding Business Day with the same force and effect as if made on the due date and no interest shall accrue for the period from and after such date. For purposes of this Note "Business Day," means each Monday, Tuesday, Wednesday, Thursday and Friday which is not a day on which banking institutions in Cincinnati, Ohio are authorized or obligated by law or executive order to close.

**Redemption**

This Note is subject to redemption upon not less than 30 days' notice by mail, at a redemption price equal to 100% of the principal amount, as a whole or in part, at the election of the Company, together with accrued interest to the redemption date.

In the event of redemption of this Note in part only, a new Note of like tenor for the unredeemed portion hereof will be issued in the name of the holder hereof upon the cancellation hereof.

## **Subordination**

The indebtedness evidenced by this Note is, to the extent and in the manner provided herein, expressly subordinate and subject in right of payment to the prior payment in full of all Senior Debt of the Company (as defined hereinbelow) whether outstanding at the date hereof or hereafter incurred. Each holder and owner of this Note, by accepting the same, agrees to and shall be bound by such provisions.

For purpose hereof, the "Senior Debt" of the Company means the principal of, premium, if any, interest on and any other payment due pursuant to any of the following, whether outstanding at the date of execution of this Note or thereafter incurred, created or assumed: (a) all indebtedness of the Company evidenced by notes, debentures, bonds or other securities sold by the Company for money, excluding this Note, but including all first mortgage bonds of the Company outstanding from time to time; (b) all indebtedness of others of the kinds described in the preceding clause (a) assumed by or guaranteed in any manner by the Company, including through an agreement to purchase, contingent or otherwise; and (c) all renewals, extensions or refundings of indebtedness of the kinds described in any of the preceding clauses (a) and (b); unless, in the case of any particular indebtedness, renewal, extension or refunding, the instrument creating or evidencing the same or the assumption or guarantee of the same expressly provides that such indebtedness, renewal, extension or refunding is not superior in right of payment to or is *pari passu* with this Note.

In the event and during the continuation of any default in the payment of principal, premium, interest or any other payment due on any Senior Debt continuing beyond the period of grace, if any, specified in the instrument evidencing such Senior Debt, unless and until such default shall have been cured or waived or shall have ceased to exist, or in the event that the maturity of any Senior Debt has been accelerated because of a default, then no payment shall be made by the Company with respect to the principal of or interest on this Note.

In the event that, notwithstanding the foregoing, any payment shall be received by the holder of this Note when such payment is prohibited by the preceding paragraph, such payment shall be held in trust for the benefit of, and shall be paid over or delivered to, the holders of Senior Debt or their respective representatives, or to the trustee or trustees under any indenture pursuant to which any of such Senior Debt may have been issued, as their respective interests may appear.

Upon any payment by the Company, or distribution of assets of the Company of any kind or character, whether in cash, property or securities, to creditors upon any dissolution or winding-up or liquidation or reorganization of the Company, whether voluntary or involuntary or in bankruptcy, insolvency, receivership or other proceedings, all amounts due or to become due upon all Senior Debt shall first be paid in full, or payment thereof provided for in money in accordance with its terms, before any payment is made on account of the principal or interest on this Note; and upon any such dissolution or winding-up or liquidation or reorganization any payment by the Company,

or distribution of assets of the Company of any kind or character, whether in cash, property or securities, to which the holder of this Note would be entitled, except for the provisions of this Note, shall be paid by the Company or by any receiver, trustee in bankruptcy, liquidating trustee, agent or other person making such payment or distribution, or by the holder of this Note if received by it, directly to the holders of Senior Debt (pro rata to such holders on the basis of the respective amounts of Senior Debt held by such holders, as calculated by the Company) or their representative or representatives, or to the trustee or trustees under any indenture pursuant to which any instruments evidencing any Senior Debt may have been issued, as their respective interests may appear, to the extent necessary to pay all Senior Debt in full, in money or money's worth, after giving effect to any concurrent payment or distribution to or for the holders of Senior Debt, before any payment or distribution is made to the holder of this Note.

In the event that, notwithstanding the foregoing, any payment or distribution of assets of the Company of any kind or character, whether in cash, property or securities, prohibited by the foregoing, shall be received by the holder of this Note before all Senior Debt is paid in full, or provision is made for such payment in money in accordance with its terms, such payment or distribution shall be held in trust for the benefit of and shall be paid over or delivered to the holders of Senior Debt or their representative or representatives, or to the trustee or trustees under any indenture pursuant to which any instruments evidencing any Senior Debt may have been issued, as their respective interests may appear, as calculated by the Company, for application to the payment of all Senior Debt remaining unpaid to the extent necessary to pay all Senior Debt in full in money in accordance with its terms, after giving effect to any concurrent payment or distribution to or for the holders of such Senior Debt.

For purposes of this Note, the words, "cash, property or securities" shall not be deemed to include shares of stock of the Company as reorganized or readjusted, or securities of the Company or any other corporation provided for by a plan of reorganization or readjustment, the payment of which is subordinated with respect to this Note to the payment of all Senior Debt which may at the time be outstanding; provided that (i) the Senior Debt is assumed by the new corporation, if any, resulting from any such reorganization or readjustment, and (ii) the rights of the holders of the Senior Debt are not, without the consent of such holders, altered by such reorganization or readjustment. The consolidation of the Company with, or the merger of the Company into, another corporation or the liquidation or dissolution of the Company following the conveyance or transfer of its property as an entirety, or substantially as an entirety, to another corporation upon the terms and conditions provided for in this Note shall not be deemed a dissolution, winding-up, liquidation or reorganization for the purposes hereunder if such other corporation shall, as a part of such consolidation, merger, conveyance or transfer, comply with the conditions stated hereunder.

Subject to the payment in full of all Senior Debt, the rights of the holder of this Note shall be subrogated to the rights of the holders of Senior Debt to receive payments or distributions of cash, property or securities of the Company applicable to the Senior Debt; and, for the purposes of such subrogation, no payment or distributions to the holders of the Senior Debt of any cash, property or securities to which the holder of this Note would be entitled except for the provisions hereunder, and no payment over to or for the benefit of the holders of Senior Debt by the holder of this Note, shall, as between the Company, its creditors other than holders of Senior Debt, and the holder of this Note, be deemed to be a payment by the Company to or on account of the Senior Debt. It is understood that the subordination provisions of this Note are and are intended solely for the purposes of defining the relative rights of the holder of this Note, on the one hand, and the holders of the Senior Debt on the other hand.

Nothing contained in this Note is intended to or shall impair, as between the Company, its creditors other than the holders of Senior Debt, and the holder of this Note, the obligation of the Company, which is absolute and unconditional, to pay the principal of and interest on this Note as and when the same shall become due and payable in accordance with their terms, or is intended to or shall affect the relative rights of the holder of this Note and creditors of the Company other than the holders of the Senior Debt, nor shall anything herein or therein prevent the holder of this Note from exercising all remedies otherwise permitted by applicable law upon default hereunder, subject to the rights, if any, of the holders of Senior Debt in respect of cash, property or securities of the Company received upon the exercise of any such remedy.

### **Events of Default**

“Event of Default,” wherever used herein with respect to this Note, means any one of the following events (whatever the reason for such Event of Default and whether it shall be voluntary or involuntary or be effected by operation of law or pursuant to any judgment, decree or order of any court or any order, rule or regulation of any administrative or governmental body):

- (1) default in the payment of any interest upon this Note when it becomes due and payable, and continuance of such default for a period of 30 days; or
- (2) default in the payment of the principal of this Note at its maturity; or
- (3) default in the performance, or breach, of any covenant or warranty of the Company in this Note (other than a covenant or warranty a default in whose performance or whose breach is elsewhere specifically dealt with) and continuance of such default or breach for a period of 90 days after there has been given, by registered or certified mail, to the Company by the holder of the Note a written notice specifying such default or breach and requiring it to be remedied and stating that such notice is a “Notice of Default” hereunder; or

(4) the entry by a court having jurisdiction in the premises of (A) a decree or order for relief in respect of the Company in an involuntary case or proceeding under any applicable Federal or state bankruptcy, insolvency, reorganization or other similar law or (B) a decree or order adjudging the Company a bankrupt or insolvent, or approving as properly filed a petition seeking reorganization, arrangement, adjustment or composition of or in respect of the Company under any applicable Federal or state law, or appointing a custodian, receiver, liquidator, assignee, trustee, sequestrator or other similar official of the Company or of any substantial part of its property, or ordering the winding up or liquidation of its affairs, and the continuance of any such decree or order for relief or any such other decree or order un-stayed and in effect for a period of 90 consecutive days; or

(5) the commencement by the Company of a voluntary case or proceeding under any applicable Federal or state bankruptcy, insolvency, reorganization or other similar law or of any other case or proceeding to be adjudicated a bankrupt or insolvent, or the consent by it to the entry of a decree or order for relief in respect of the Company in an involuntary case or proceeding under any applicable Federal or state bankruptcy, insolvency, reorganization or other similar law or to the commencement of any bankruptcy or insolvency case or proceeding against it, or the filing by it of a petition or answer or consent seeking reorganization or relief under any applicable Federal or state law, or the consent by it to the filing of such petition or to the appointment of, or taking possession of the Company or of any substantial part of its property by, a custodian, receiver, liquidator, assignee, trustee, sequestrator or other similar official or the making by the Company of an assignment for the benefit of creditors, or the admission by it in writing of its inability to pay its debts generally as they become due, or the taking of corporate action by the Company in furtherance of any such action; or

If an Event of Default (other than an Event of Default specified in paragraphs (4) or (5) above) occurs and is continuing, then the holder of this Note may declare the principal amount to be due and payable immediately, by a notice in writing to the Company, and upon any such declaration such principal amount shall become immediately due and payable. If an Event of Default specified in paragraphs (4) or (5) above occurs, the principal amount of this Note shall automatically, and without any declaration or other action on the part of the holder, become immediately due and payable.

No delay or omission of the holder of this Note to exercise any right or remedy accruing upon any Event of Default shall impair any such right or remedy or constitute a waiver of any such Event of Default or an acquiescence therein. Every right and remedy given by this Note or by law to the holder may be exercised from time to time, and as often as may be deemed expedient, by the holders.



### **Consolidations and Mergers Permitted**

Nothing contained in this Note shall prevent any consolidation or merger of the Company with or into any other corporation or corporations (whether or not affiliated with the Company), or successive consolidations or mergers in which the Company or its successor or successors shall be a party or parties, or shall prevent any sale, conveyance, transfer or other disposition of the property of the Company or its successor or successors as an entirety, or substantially as an entirety, to any other corporation (whether or not affiliated with the Company or its successor or successors) authorized to acquire and operate the same; provided, however, the Company hereby covenants and agrees that, upon any such consolidation, merger, sale, conveyance, transfer or other disposition, the due and punctual payment of the principal of and interest on this Note in accordance with its terms, according to its tenor, and the due and punctual performance and observance of all the covenants and conditions of hereunder to be kept or performed by the Company, shall be expressly assumed, by written agreement satisfactory in form to the holder executed and delivered to the holder by the entity formed by such consolidation, or into which the Company shall have been merged, or by the entity which shall have acquired such property.

In case of any such consolidation, merger, sale, conveyance, transfer or other disposition and upon the assumption by the successor corporation of the due and punctual payment of the principal of and interest on this Note and the due and punctual performance of all of the covenants and conditions hereunder to be performed by the Company, such successor corporation shall succeed to and be substituted for the Company, with the same effect as if it had been named herein as the party of the first part, and thereupon the predecessor corporation shall be relieved of all obligations and covenants under this Note.

Nothing contained in this Note shall prevent the Company from merging into itself or acquiring by purchase or otherwise all or any part of the property of any other corporation (whether or not affiliated with the Company).

IN WITNESS WHEREOF, the Company has caused this instrument to be duly executed.

Dated:

**UNION LIGHT, HEAT & POWER COMPANY**

**By:**

**Name:** \_\_\_\_\_

**Title:** \_\_\_\_\_



**The Union Light, Heat and Power Company**

**Summary of Loan Agreement Pricing Parameters**

<b>Principal Amount:</b>	Up to \$200 million of tax exempt bonds, in one or more series.
<b>Maturity:</b>	Up to 40 years.
<b>Purpose:</b>	To finance or reimburse the costs of acquiring and/or constructing certain solid waste facilities or other environmental-control facilities.
<b>Lead Underwriters:</b>	To be named.
<b>Underwriting Commissions or Agents' Fees:</b>	Not to exceed 1.25% of the principal amount.
<b>Price to Public:</b>	No higher than 101-1/2% nor less than 98% of the principal amount, plus accrued interest, if any.
<b>Interest Rate:</b>	Not to exceed those generally obtainable at the time of pricing or re-pricing of such Loan Agreements for instruments having the same or reasonably similar maturities and having reasonably similar terms, conditions and features issued by utility companies or utility holding companies of the same or reasonably comparable credit quality. The public offering price will be no higher than 101-1/2% nor less than 98% of the principal amount of the Authority's Bonds, plus accrued interest, at an interest rate that may be either fixed or subject to adjustment at varying periods, but in either case not to be in excess of 10.0% per annum at the time of initial issuance.



**Union Light, Heat and Power Company**  
**Detail of Estimated Construction and Acquisition Expenditures**  
**(807 KAR 5:001 Section 11 (1)(d))**

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>Total</u>
<b>Gas Department</b>				
Production	276,320	282,427	288,798	847,546
Special Projects	11,570,821	12,578,408	17,628,959	41,778,188
Distribution	10,922,641	11,342,012	12,672,650	34,937,303
Building & Grounds	298,988	305,414	345,336	949,738
Meters	1,379,812	3,283,915	4,210,094	8,873,820
<b>Total Gas Department</b>	<u>24,448,583</u>	<u>27,792,175</u>	<u>35,145,837</u>	<u>87,386,595</u>
<b>Electric Department</b>				
Substations - Transmission	2,485,446	816,091	-	3,301,537
Substations - Distribution	3,980,817	3,050,646	4,044,567	11,076,030
Transmission Lines	348,523	555,634	679,020	1,583,177
Distribution Transformers	1,242,868	1,258,332	1,292,697	3,793,896
Line Extensions	4,793,678	4,856,215	4,915,054	14,564,947
Street Lights	462,036	457,734	469,166	1,388,936
Generation - Acquisition	371,645,000	-	-	371,645,000
Generation - Construction	39,369,000	23,681,000	40,924,000	103,974,000
Distribution Improvements	5,693,519	6,313,164	5,581,208	17,587,892
Buildings & Grounds	240,622	243,616	276,740	760,977
Meters & Instrument Transform	693,765	3,435,981	4,537,878	8,667,624
Transportation	20,330	23,587	19,251	63,168
<b>Total Electric Department</b>	<u>430,975,603</u>	<u>44,692,000</u>	<u>62,739,581</u>	<u>538,407,184</u>
<b>Other Common Plant and Equipment</b>	<u>2,163,365</u>	<u>2,069,966</u>	<u>1,073,186</u>	<u>5,306,517</u>
<b>Total Construction and Acquisition Expense</b>	<u>457,587,551</u>	<u>74,554,141</u>	<u>98,958,604</u>	<u>631,100,296</u>



THE UNION LIGHT, HEAT AND POWER COMPANY

FINANCIAL EXHIBIT

September 30, 2004

807 KAR 5:001, SECTION 6

(1.) Amount and kinds of stock authorized.

1,000,000 shares of Capital Stock \$15 per share par value amounting to \$15,000,000 total par value.

(2.) Amount and kinds of stock issued and outstanding.

585,333 shares of Capital Stock \$15 per share par value amounting to \$8,779,995 total par value plus additional paid in capital thereon of \$23.541 million.

(3.) Terms of preference of preferred stock whether cumulative or participating, or on dividends or assets or otherwise.

There is no preferred stock authorized, issued or outstanding.

(4.) Brief description of each mortgage on property of applicant, giving date of execution, name of mortgagor, name of mortgagee, or trustee, amount of indebtedness authorized to be secured thereby, and the amount of indebtedness actually secured, together with any sinking fund provisions.

The Union Light, Heat and Power Company, as of February 1, 1949, executed its "First Mortgage" to The Bank of New York, Trustee, as security for the issuance of First Mortgage Bonds. As of October 1, 1951, it executed the "First Supplemental Indenture," as of May 1, 1954, the "Second Supplemental Indenture," as of July 1, 1959, the "Third Supplemental Indenture," as of July 1, 1963, the "Fourth Supplemental Indenture," as of June 1, 1970, the "Sixth Supplemental Indenture," as of October 1, 1973, the "Seventh Supplemental Indenture," as of December 1, 1978, the "Eighth Supplemental Indenture," as of December 15, 1981, the "Ninth Supplemental Indenture," as of July 1, 1989, the "Tenth Supplemental Indenture," as of June 1, 1990, the "Eleventh Supplemental Indenture," as of November 15, 1990, the "Twelfth Supplemental Indenture," and as of August 1, 1992, the "Thirteenth Supplemental Indenture," to said First Mortgage for the issuance of additional First Mortgage Bonds. The Company redeemed the First Mortgage Bonds issued under the First Supplemental Indenture on October 1, 1981, the Second Supplemental Indenture on May 1, 1984, the Third Supplemental Indenture on July 1, 1989, the Fourth Supplemental Indenture on July 1, 1993, the Sixth Supplemental Indenture on



September 30, 1977, the Seventh Supplemental Indenture on April 23 & 24, 1998, the Eighth Supplemental Indenture on May 1, 1996, the Ninth Supplemental Indenture on December 15, 1990, the Tenth Supplemental Indenture on September 1, 1995, the Eleventh Supplemental Indenture on June 1, 1995, the Twelfth Supplemental Indenture on February 15, 1996 and the Thirteenth Supplemental Indenture on August 1, 1999. The Company also executed a "Fifth Supplemental Indenture" as of January 1, 1967, changing certain provisions of the Mortgage. This mortgage, as amended, in the opinion of counsel for the Company, constitutes a direct first lien on all the property of the Company except rents, earnings, revenues, income or profit of the mortgaged property, cash, accounts receivable, supplies, etc. used in or held for the operation of the business. The aggregated principal amount of said Bonds at any time outstanding which may be secured by said First Mortgage presently is limited to \$200,000,000. As of September 30, 2004, the Company had issued and outstanding \$0 principal amount of First Mortgage Bonds secured under the terms of the Mortgage Indenture, as amended.

- (5.) Amount of bonds authorized, and amount issued, giving the name of the public utility which issued the same, describing each class separately, and giving date of issue, face value, rate of interest, date of maturity and how secured, together with amount of interest paid thereon during the last fiscal year.

The First Mortgage as amended, presently limits the principal amount of bonds which can be outstanding at any one time to \$200,000,000. The Company has outstanding First Mortgage Bonds, all of which are secured by the First Mortgage, as amended, of the Company to The Bank of New York, as Trustee, as follows:

<u>Indenture</u>	<u>Date of Issue</u>	<u>Principal Amount Auth. &amp; Issued</u>	<u>Rate of Interest</u>	<u>Date of Maturity</u>	<u>Interest Paid Year 2004</u>
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None Outstanding

The Company has outstanding Debentures issued under the Indenture dated as of July 1, 1995, between the Company and The Fifth Third Bank, as Trustee, as follows:

<u>Indenture</u>	<u>Date of Issue</u>	<u>Principal Amount Auth. &amp; Issued</u>	<u>Rate of Interest</u>	<u>Date of Maturity</u>	<u>Interest Paid Year 2004</u>
1st Supplement	7/25/95	\$ 15,000,000	7.65%	7/15/2025	\$1,147,500
2 <sup>nd</sup> Supplement	4/30/98	\$ 20,000,000	6.50%	4/30/2008	\$1,300,000
4 <sup>th</sup> Supplement	9/17/99	\$ 20,000,000	7.875%	9/15/2009	\$1,575,000

The Company has outstanding Debentures issued under the Indenture dated December 1, 2004 between the Company and Deutsche Bank trust Company Americas, as Trustee, as follows:

<u>Indenture</u>	<u>Date of Issue</u>	<u>Principal Amount Auth. &amp; Issued</u>	<u>Rate of Interest</u>	<u>Date of Maturity</u>	<u>Interest Paid Year 2004</u>
Indenture	12/9/04	\$40,000,000.00	5.00%	12/15/14	\$0.00

(6.) Each note outstanding, giving date of issue, amount, date of maturity, rate of interest, in whose favor, together with amount of interest paid thereon during the last fiscal year.

<u>Payee</u>	<u>Date of Issue</u>	<u>Amount</u>	<u>Date of Maturity</u>	<u>Rate of Interest</u>	<u>Interest Paid Year 2004</u>
Cinergy Corp	9/30/04	\$26,140,351	10/01/04	1.86%	-
Cinergy Services	9/30/04	\$10,754,523	10/30/04	1.75%	-

(7.) Other indebtedness, giving same by classes and describing security, if any, with a brief statement of the devolution or assumption of any portion of such indebtedness upon or by person or corporation if the original liability has been transferred, together with amount of interest paid thereon during the last fiscal year.

To the extent that capital leases are considered debt, there are \$7.314 million in current and non-current capital lease obligations at September 30, 2004.

(8.) Rate and amount of dividends paid during the five (5) previous fiscal years, and the amount of capital stock on which dividends were paid each year.

<u>Year Ending</u>	<u>Dividends Paid</u>		<u>No. of Shares</u>	<u>Par Value of Stock</u>
	<u>Per Share</u>	<u>Total (\$000)s</u>		
December 31, 1999	16.50	9,658	585,333	8,779,995
December 31, 2000	16.50	9,658	585,333	8,779,995
December 31, 2001	20.00	11,707	585,333	8,779,955
December 31, 2002	16.52	9,670	585,333	8,779,955
December 31, 2003	10.77	6,305	585,333	8,779,955

(9.) Detailed Income Statement and Balance Sheet.

See attached pages 4 through 7 of Financial Exhibit for detailed income statement for the twelve months ended September 30, 2004 and detailed balance sheet as of September 30, 2004.

THE UNION LIGHT, HEAT AND POWER COMPANY

NOTE TO FINANCIAL STATEMENTS

September 30, 2004

1. Utility plant is stated at original cost which does not represent its present day replacement or realizable value. The Kentucky statutes expressly authorize the Kentucky Public Service Commission to ascertain, for rate making purposes, the value of the property of any public utility and provide that, in making any such valuation, the Commission shall give due consideration to the history and development of the utility and its property, original cost, cost of reproduction as a going concern, and other elements of value recognized by the law of the land for rate making purposes.

THE UNION LIGHT, HEAT AND POWER COMPANY

Balance Sheet at September 30, 2004

Assets  
(Dollars in Thousands)

**Current Assets**

Cash and cash equivalents	\$7,699
Notes receivable, current	5,301
Accounts receivable less accumulated provision for doubtful accounts of \$17 at September 30, 2004,	1,937
Accounts receivable from affiliated companies	169
Fuel and supplies	10,789
Prepayments and other	427
Total current assets	<u>26,322</u>

**Property, Plant, and Equipment - at Cost**

Utility Plant in Service	
Electric	283,525
Gas	251,354
Common	53,551
Total Utility Plant in Service	<u>588,430</u>
Construction work in progress	<u>6,887</u>
Total Utility Plant	595,317
Accumulated depreciation	<u>186,142</u>
Net Property, Plant, and Equipment	<u>409,175</u>

**Other Assets**

Regulatory assets	13,182
Other	716
Total other assets	<u>13,898</u>

**Total Assets** \$449,395

THE UNION LIGHT, HEAT AND POWER COMPANY

Balance Sheet at September 30, 2004

Liabilities  
(Dollars in Thousands)

**Current Liabilities**

Accounts payable	\$3,145
Accounts payable to affiliated companies	18,701
Accrued taxes	5,804
Accrued interest	997
Notes payable to affiliated companies	36,895
Other	6,738
Total Current Liabilities	<u>72,280</u>

**Non-Current Liabilities**

Long-term debt	54,708
Deferred income taxes	59,546
Unamortized investment tax credits	2,687
Accrued pension and other postretirement benefit costs	14,829
Accrued cost of removal	29,029
Other	13,681
Total Non-Current Liabilities	<u>174,480</u>

Total Liabilities 246,760

**Common Stock Equity**

Common stock-\$15.00 par value; authorized shares- 1,000,000; outstanding shares-- 585,333	8,780
Paid-in capital	23,541
Retained earnings	170,803
Accumulated other comprehensive loss	(489)
Total Common Stock Equity	<u>202,635</u>

Total Liabilities and Shareholders' Equity \$449,395

THE UNION LIGHT, HEAT AND POWER COMPANY

Income Statement

For The Twelve Months Ended September 30, 2004  
(Dollars in Thousands)

**Operating Revenues**

Electric	\$228,555
Gas	120,308
<b>Total Operating Revenues</b>	<u>348,863</u>

**Operating Expenses**

Electricity purchased from parent company for resale	158,535
Gas purchased	76,732
Operation and maintenance	55,084
Depreciation	19,677
Taxes other than income taxes	3,105
<b>Total Operating Expenses</b>	<u>313,133</u>

**Operating Income** 35,730

**Miscellaneous Income – Net** 1,330

**Interest Expense** 5,367

**Income Before Taxes** 31,693

**Income Taxes** 10,862

**Net Income** \$20,831