

SECURITIES AND EXCHANGE COMMISSION**(Release No. 35-28066; 70-10254)****Cinergy Corp., et al.****Order Authorizing Sale of Utility Assets and Denying Request for Hearing****November 29, 2005**

Cinergy Corp. ("Cinergy"), a registered holding company, and its wholly-owned public utility subsidiary, The Cincinnati Gas & Electric Company, ("CG&E," and together with Cinergy, "Declarants"), a public utility holding company exempt from registration under Section 3(a)(2) of the Public Utility Holding Company Act of 1935, as amended, ("Act"), by Rule 2, both of Cincinnati, Ohio, have jointly filed a declaration ("Declaration") under Sections 12(b), 12(d) and 12(f) and Rules 43, 44, 45 and 54 under the Act. On January 21, 2005, the Securities and Exchange Commission ("Commission") published a notice of the Declaration (HCAR No. 27940).

The Office of the Ohio Consumers' Counsel ("OCC") filed its request for hearing ("Request") with the Commission on February 14, 2005. The OCC states that it is empowered under Ohio law to represent the interest of the state's residential consumers in proceedings before state and federal administrative agencies and courts. On March 4, 2005, Declarants filed a response ("Response") and on March 25, 2005, the OCC filed a reply ("Reply"). On May 11, 2005, the Chairman of the Public Utilities Commission of Ohio ("Ohio Commission") sent a letter to then-Chairman Donaldson clarifying certain issues raised by OCC that pertain to rate and restructuring orders of the state commission ("Ohio Commission Letter"). On May 23, 2005, Declarants amended the Declaration

with a copy of the Ohio Commission Letter. On June 2, 2005, OCC filed a reply to the Amended Declaration ("June Reply").

I. Background

Cinergy, through its public utility subsidiary companies, CG&E, Union Light, Heat & Power ("Union") and PSI Energy, Inc. ("PSI"), provides retail electric and natural gas service to customers in southwestern Ohio, northern Kentucky and most of Indiana. In addition, Cinergy has numerous non-utility subsidiaries. As of the year ended December 31, 2004, Cinergy reported consolidated total assets of approximately \$15.0 billion and consolidated total operating revenues of approximately \$4.7 billion. Cinergy directly holds all the outstanding common stock of CG&E.

CG&E is an Ohio combination electric and gas public utility company and exempt holding company. CG&E is engaged in the production, transmission, distribution and sale of electric energy and the sale and transportation of natural gas in the southwestern portion of Ohio and, through its public-utility subsidiary, Union, in northern Kentucky. The area served by CG&E with electricity, gas, or both is approximately 3,200 square miles, has an estimated population of two million people, and includes the cities of Cincinnati and Middletown in Ohio, and Covington and Newport in Kentucky. As of the year ended December 31, 2004, CG&E reported consolidated total operating revenues of approximately \$2.5 billion and consolidated total assets of approximately \$6.2 billion.

The Ohio Commission regulates CG&E's retail sales of electricity and natural gas. CG&E's wholesale power sales and transmission services are regulated by the Federal

Energy Regulatory Commission ("FERC") under the Federal Power Act. CG&E directly holds all the outstanding common stock of Union.

Union, formed under Kentucky law, is engaged in the transmission, distribution, and sale of electric energy and the sale and transportation of natural gas in northern Kentucky. The area that Union serves with electricity and gas covers approximately 500 square miles, has an estimated population of 330,000 people, and includes the cities of Covington and Newport, Kentucky. Union has historically relied on CG&E for its full requirements of electric supply to serve its retail customers. Union has no wholesale customers. Its retail sales of electricity and of natural gas are regulated by the Kentucky Public Service Commission ("Kentucky Commission"). As of the year ending December 31, 2004, Union reported total operating revenues of approximately \$355 million and total assets of approximately \$468 million.

II. Proposed Transfer

CG&E proposes to transfer (the "Transfer") to Union, at Net Book Value ("NBV"), CG&E's ownership interest in three electric generating facilities, including certain realty and other improvements, equipment, assets, properties, facilities and rights (collectively, the "Plants"). As of December 31, 2004, the Plants had a NBV of approximately \$351 million (not including construction-work-in-progress ("CWIP") of approximately \$19.9 million).¹

¹ The three electric generating stations that are the subject of the Transfer are: East Bend Generating Station in Rabbit Hash, Kentucky ("East Bend"); the Miami Fort Unit 6 in North Bend Ohio ("Miami Fort 6"); and the Woodsdale Generating Station in Trenton, Ohio ("Woodsdale").

East Bend is a 648 MW coal-fired base load station. It is jointly owned by CG&E (69 percent) and The Dayton Power & Light Company ("DP&L") (31 percent). CG&E

Declarants' plan to transfer an appropriate amount of equity and debt associated with the Plants in a tax-efficient manner, while maintaining the strong investment grade ratings of CG&E and Union.² At the closing of the Transfer of the Plants, Declarants expect the consideration for the Transfer to consist of the following:

- 1) an assumption by Union of certain short-and long-term debt of CG&E (in an aggregate principal amount estimated to be in the range of \$140-160 million);
- 2) a further equity contribution by CG&E to Union (estimated to be in the range of \$160-180 million); and
- 3) the transfer from CG&E to Union of certain accumulated deferred income taxes and accumulated deferred income tax credits (estimated at December 31, 2004 to total approximately \$68 million).

Declarants state that the debt to be assumed by Union will consist of (i) all debt related specifically to the Plants (comprised of long-term tax exempt debt in an aggregate principal amount of \$75 million, the proceeds of which were loaned by the issuing

proposes to transfer its ownership share (447 MW nameplate rating) to Union. As of December 31, 2004, the NBV of CG&E's ownership interest in East Bend was approximately \$193 million (not including CWIP of approximately \$5,347,342 million).

Miami Fort 6 is a 168 MW coal-fired intermediate load generating unit. It is wholly-owned by CG&E, but is part of the larger Miami Fort Generating Station, which is jointly owned by CG&E and DP&L. As of December 31, 2004, Miami Fort 6 had a NBV of approximately \$18 million (not including CWIP of approximately \$9,171).

Woodsdale is a 490 MW dual-fuel combustion-turbine peaking station that operates on either natural gas or propane. Woodsdale is wholly-owned by CG&E. As of December 31, 2004, the NBV of Woodsdale was approximately \$140 million (not including CWIP of approximately \$14,577,793 million).

² At December 31, 2004, each of CG&E's and Union's senior unsecured debt was rated BBB+ by Fitch Ratings, Baa1 by Moody's Investors Service and BBB by Standard & Poor's Ratings Service. Declarants represent that the structure of the financing essentially as a 50/50 debt/equity-financed acquisition should have no adverse impact on the ratings of either company.

authorities to CG&E in connection with financing for the construction or improvement of East Bend) and (ii) certain short-term debt of CG&E.

The assumption of debt will not operate to effect a release of CG&E from its obligations to the counterparty on the assumed debt. Declarants state, however, that as between CG&E and Union, Union will be responsible for repayment of the debt (including by prompt reimbursement of CG&E of amounts of principal and interest due and payable with respect to such assumed debt) from and after the effective date of the assumption. Union's responsibility will be evidenced by a note payable on Union's books. In addition, Cinergy commits that not later than two years after the closing of the Transfer, all of the CG&E debt assumed by Union will be repaid by Union (as it comes due or by prepayment, redemption or otherwise), including by one or more refinancings effected by Union, fully satisfying or otherwise extinguishing all of CG&E's liability on such debt.

Union will also compensate CG&E at cost for inventories, as of the closing date, of fuels, supplies, materials and spare parts of CG&E located at or in transit to the Plants. Also at closing, Union will reimburse CG&E for the transaction costs incurred by CG&E or any of its affiliates in connection with the Transfer.

Declarants state that the Plants are in good operating condition and are directly interconnected to the Cinergy joint transmission system. CG&E will retain all transmission facilities and generation step-up transformers or other FERC-jurisdictional facilities that are physically connected to the Plants.

CG&E will continue to operate Miami Fort 6 following the Transfer. Union will operate East Bend and Woodsdale with assistance, provided at cost, from Cinergy

Services, Inc. (Cinergy's service company subsidiary) in accordance with its utility service agreement and with assistance from CG&E, on an as-needed basis, pursuant to the exemption under Rule 87(a)(3).

Declarants represent that, following the Transfer, the Plants will be dispatched under a new Purchase, Sale and Operation Agreement ("PSOA") in exactly the same manner as they are today, *i.e.*, jointly with CG&E's remaining generation facilities and those of its affiliate, PSI. FERC approved the PSOA on June 2, 2005, after an adjustment to the pricing provisions.

The Declarants state that the Transfer meets the Kentucky Commission's desire for Union to acquire physical generating assets to serve its retail electric customers. The Kentucky Commission approved the Transfer in December 2003 and issued its final order on June 17, 2005. The state commission found the Transfer to be in the best interest of Union and its customers and it urged this Commission to give weight to its findings. The Ohio Commission has not objected to the Transfer and, according to Declarants, Ohio state law does not require its approval.

III. Request for Hearing

The OCC suggests four bases for rejecting the proposed Transfer. First, OCC argues that the Transfer price should be based upon the market value of the generating assets rather than NBV. Second, OCC argues that the Transfer would have a negative impact on competition, and thus would violate section 12(d). Third, OCC argues that the proposed Transfer would harm consumers, both in terms of rates and in terms of cost shifts. Finally, OCC argues that the Transfer violates Ohio law, including prior decisions of the Ohio Commission. In particular, the OCC contends that the proposed Transfer

would violate CG&E's corporate separation plan, which the Ohio Commission has approved as consistent with the Ohio electric restructuring legislation. The Commission addresses each of these issues below.

A. Statutory Requirements

The proposed Transfer by CG&E is subject to Section 12(d) of the Act and Rule 44(a).³ Section 12(d) of the Act makes it unlawful for a registered holding company or subsidiary to sell any utility assets in contravention of Commission rules or orders

...regarding the consideration to be received for such sale, maintenance of competitive conditions, fees and commissions ... and similar matters as the Commission deems necessary or appropriate in the public interest or for the protection of investors or consumers ... [the "protected interests"] under the Act.

Rule 44(a) requires the filing of a declaration in connection with a proposed sale of utility assets. Union's acquisition of the Plants is exempt by operation of Section 9(b) because the Kentucky Commission has approved it.⁴

B. Use of Net Book Value ("NBV") to Set the Transfer Price

OCC argues that the Transfer should occur at market value rather than at NBV. The Commission has consistently required that intrasystem transfers of utility assets occur at cost, and hence has consistently approved intrasystem transactions in which the

³ Sections 12(b) and 12(f) and the rules promulgated thereunder are also applicable to the proposed Transfer. These aspects of the Transfer are not in dispute and, based upon a review of the record before it, the Commission finds that the requirements of these sections have been satisfied.

⁴ *The Application of [Union] for a Certification of Public Convenience to Acquire Certain Generation Resources and Related Property...*, Kentucky Commission Case No. 2003-00252 "Interim Order" (December 3, 2003), *aff'd* by "Non-Interim Order" (June 17, 2005).

assets were priced at NBV.⁵ In fact, in Cinergy's 2000 Omnibus Financing Order, *Cinergy Corp.*, HCAR 27190 (June 23, 2000), the Commission authorized additional financing for Cinergy to establish affiliated entities that would receive the Plants at NBV.⁶ In general practice and with regard to this specific company, the Commission has consistently accepted NBV as the basis for intrasystem transfer price.

The Commission's approval of NBV pricing for intrasystem transfers of assets has occurred under both section 12, which governs the sale of a utility asset, and section 10, which governs the purchase of a utility asset. As the Commission explained in *Georgia Power Co., Holding Co.* Act Release No. 23448 (Oct. 10, 1984), a case in which it rejected a hearing request that urged that a sale occur at market value, intrasystem pricing at "book value" guards against mere "paper profits from intercompany transactions," an abuse against which the Act was directed.⁷

⁵ *Allegheny Energy Inc.*, HCAR No. 27205 (2000) (public-utility subsidiary in Maryland authorized to transfer generation assets to non-utility affiliate in Pennsylvania at NBV); *Entergy Corporation*, HCAR 25136 (1990), appealed on other grounds, *sub. nom.*, *City of New Orleans v. SEC*, 969 F.2d 1163 (D.C. Cir. 1992), *aff'd*, *Entergy Corp.*, HCAR No. 26410 (1995) (public-utility subsidiary in Arkansas authorized to transfer generation assets at NBV to Delaware affiliate); *Cedar Coal Co.*, HCAR No. 24181(1986) (two Ohio subsidiaries authorized to transfer at NBV assets that were located in West Virginia to intermediate subsidiary, also in Ohio); *Gulf Power Co.*, HCAR No. 19696 (1976) (utility subsidiary authorized to sell 50% of utility asset to associate utility for 50% of NBV).

⁶ Under that proposal, the contemplated transferee was an affiliated exempt wholesale generator ("EWG"). The fact that Union is not an EWG is addressed *infra*. But, even if Union were an affiliated EWG, the transfer would still be at NBV. See e.g., *Ameren Corp.*, HCAR No. 27960 (April 19, 2005); *Alliant Energy Corp.*, HCAR No. 27930 (Dec. 28, 2004); *WGL Holdings, et al.* HCAR No. 27827 (April 1, 2004); *National Fuel Gas Co.*, HCAR No. 27600 (Nov. 12, 2002); *Carolina Power & Light*, HCAR No. 27474 (Dec. 10, 2001) (intermediate subsidiary to transfer assets to subsidiary EWG at NBV).

⁷ See Section 1(b)(1) of the Act; *Georgia Power*, text at nn. 11 - 15 (Westlaw p. 4) (*Georgia Power* was a Section 10 order but the following discussion cites Section 12(d)

We do not believe that there is any reason for the Commission to alter its approach to intrasystem asset sales in this matter. Indeed, because the sale is fully transparent, nothing about this transaction should hinder the ability of the Ohio Commission to exercise its jurisdiction over the relevant rates and to protect Ohio consumers if necessary. OCC's claim that the sale should be conducted at market value thus does not raise a material issue of fact or law.

C. Maintenance of Competitive Conditions

OCC also contends that the Transfer "will not maintain competitive conditions," as required by Section 12(d) of the Act.⁸ In this regard, OCC contends that the proposed Transfer will have a negative impact on the competition to serve the load that is currently served by the Plants.⁹ By selling the Plants to Union, OCC contends, Declarants will

orders in support, making the discussion directly relevant to the Applicants' Declaration, which is made under Section 12(d)):

[I]n the case of an acquisition from an associate company, the Act has been interpreted not to permit a sale at a profit. The price is limited to cost. This interpretation has long been followed in the administration of the Act. . . . It was, as applied to current transfer, merely a corollary of one of the reforms imposed on utility companies by the Act and related legislation to eliminate past inter-company profits from the plant accounts of substantially all utility companies in the United States. . . . [Intercompany profit] was included in the list of abuses in Section 1(b)(1) of the Act, characterized as 'paper profits from inter-company transactions.'

The exact term, "book value," is found at the penultimate discussion paragraph (Westlaw p.6). The point of *Georgia Power*, and the point here, is that intrasystem transfers priced at book value (*i.e.*, at cost), as opposed to fair value (*i.e.*, market), do satisfy the requirements of the Act.

⁸ Request at 9.

⁹ *Id.*; Reply at 9.

keep that load from being served by alternative suppliers which, in turn, will adversely affect Ohio consumers.¹⁰

OCC's complaint misapprehends the point of the competitive conditions requirement. As evidenced by numerous Commission decisions, the competitive conditions that Section 12(d) seeks to maintain are those that surround an offer to sell assets, not the competition for the power generated by the assets or for the load that is served by the assets. The Commission's 1946 decision in *Interstate Power Company* illustrates this point.¹¹ There, in discussing whether a proposed sale of utility assets met the competitive conditions requirement, the Commission stated:¹²

[W]hatever procedure is chosen by a particular seller should be designed to afford all interested persons who would qualify as purchasers a fair opportunity to make offers, and to secure for the seller the maximum price reasonably obtainable.

There is no basis in Commission precedent for concluding that the competitive conditions requirement of Section 12(d) applies to the underlying power market. Moreover, in the context of an intrasystem asset transfer, as opposed to a sale to a third party, the requirement of an open bidding process makes little sense -- instead, as outlined above, the use of book value pricing rather than sale price maximization serves to prevent abuses. Any potential impact of the transfer on the underlying electric market, and hence on utility rates, can be addressed by the state commissions. OCC's objection thus does not raise a material issue of fact or law that warrants a hearing.

¹⁰ See Request at 9; Reply at 9 - 10.

¹¹ 22 SEC 447 (1946).

¹² *Id.* at 452 (referencing *Standard Gas and Electric Company*, 20 SEC 738 (1945)).

D. Consumer Protection

OCC's arguments about the manner in which this Transfer could harm consumers in terms of rates and cost-shifts are also misplaced in this proceeding. The Commission's approach is to act in a manner that does not prevent the Ohio Commission from treating any potential rate-impact of the Transfer in whatever manner it deems appropriate. In this context, the Transfer is transparent and, from the perspective of the Act, the only issue raised by OCC that is properly before the Commission under Section 12(d) is the use of book value pricing, which precedent demonstrates is intended to minimize the risk that the intrasystem transfer is abusive. The same is true of OCC's arguments that the Transfer will benefit Kentucky customers at the expense of Ohio customers. The Commission's approach is to act in a manner that does not prevent either state commission from protecting consumers in terms of cost-shifts, while at the same time protecting investors under the Act by rejecting "sweetheart" deals, whether they occur within or across state lines, and by ensuring proper holding company structure. As discussed, we believe that the proposed Transfer satisfies the relevant statutory provisions under the Act.

E. State Law

OCC further asserts that the proposed transfer violates Ohio law. We do not believe that this issue is germane to the proceeding. The interpretation and enforcement of state utility law is a function most appropriately performed by the relevant state commissions.

IV. Rule 54

Declarants state, for purposes of Rule 54, that the conditions specified in Rule 53(a) are satisfied and that none of the adverse conditions specified in Rule 53(b) exist. As a result, the Commission will not consider the effect on the Cinergy system of the capitalization or earnings of any Cinergy subsidiary that is an EWG or FUCO, as each is defined in sections 32 and 33 of the Act, respectively, in determining whether to approve the proposed transactions.

V. Conclusion

Declarants state that, with the exception of the Kentucky Commission, which has issued its approval, no state or federal commission other than this Commission has jurisdiction over the proposed Transfer. Declarants state that fees and expenses in connection with the Declaration will be approximately \$5,000.

Due notice of the filing of the Declaration was given in the manner prescribed by Rule 23 under the Act, and no hearing was ordered by the Commission. Based on the facts in the record, it is found that the applicable standards of the Act and the rules under the Act are satisfied and that no adverse findings are necessary.

IT IS ORDERED, under the applicable provisions of the Act and the rules under the Act, that the Declaration, as amended, shall be permitted to become effective immediately, subject to the terms and conditions prescribed in Rule 24 under the Act.

IT IS FURTHER ORDERED that the protest and motion for hearing are denied.

By the Commission.



Jonathan G. Katz
Secretary