110 FERC ¶ 61,212

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeen G. Kelly.

Union Light, Heat and Power Company and The Cincinnati Gas & Electric Company	Docket Nos. ER04-1248-000 ER04-1248-001 ER04-1247-000

ORDER ACCEPTING FILING

(Issued March 3, 2005)

1. In this order, we accept for filing the executed Purchase, Sale and Operation Agreement (PSOA) submitted for filing by Union Light, Heat and Power Company (Union) and The Cincinnati Gas & Electric Company (Cincinnati) (collectively, the Filing Parties), subject to the condition discussed below. We also accept the cancellation of a long-term power sales agreement between Cincinnati and Union. This order benefits customers by ensuring that the price for sales of energy between affiliates reflects market prices.

The Filings

2. On September 27, 2004, the Filing Parties filed an executed PSOA providing for the continued integration of Union's and Cincinnati's generation plants with PSI Energy Inc.'s (PSI) generation facilities in light of the recent transfer of three of Cincinnati's generating plants (Plants) to Union. Concurrently with this filing, the Filing Parties also submitted a cancellation of Rate Schedule FERC No. 56, a long-term agreement under which Cincinnati currently sells full requirements power to Union. With its acquisition of the Plants, Union states that it will no longer require power under the long-term agreement.[1] On January 11, 2005, to address possible affiliate issues, the Commission issued a deficiency letter requiring the Filing Parties to provide actual data showing comparable purchase and sale prices. On January 26, 2005, the Filing Parties filed a response to the deficiency letter.

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[1] Also, concurrently with these filings, the Filings Parties submitted a related Facilities Operation Agreement in Docket No. ER04-1249-000, which will be addressed by a separate order.

3. The Filing Parties request that the Commission approve the PSOA no later than March 1, 2005, to permit closing of the transfer of the Plants on March 30, 2005. The Filing Parties initially requested that the effective date of the PSOA and of the rate schedule cancellation be the date of closing of the transfer of the Plants. In their response to the deficiency letter, however, the Filing Parties request to defer the effectiveness of the PSOA until the Midwest ISO Day 2 market becomes effective, *i.e.*, April 1, 2005 at the earliest. They request waiver of section 35.3 of the Commission's regulations if necessary to permit the effective date.

Background

4. Union, a Kentucky corporation and wholly-owned, direct subsidiary of Cincinnati, transmits, distributes, and sells electric energy and transports and sells natural gas to customers in northern Kentucky. Cincinnati, an Ohio corporation and wholly-owned direct subsidiary of Cinergy Corp., is a combination electric and gas public utility company. Cincinnati has three wholly-owned utility subsidiaries: Union; Miami Power Corporation, an Indiana corporation; and KO Transmission Company, a Kentucky corporation. In addition, Cincinnati has one wholly owned non-utility subsidiary, Tri-State Improvement Company.

5. The Filing Parties currently engage in joint economic dispatch of their combined portfolio of generation assets under the Joint Generation Dispatch Agreement (Joint Dispatch Agreement).[2] Pursuant to the Joint Dispatch Agreement between affiliates Cincinnati and PSI, their parent company, Cinergy, dispatches the Cincinnati and PSI generation fleets (including Union's plants) to meet the retail and wholesale load requirements of the companies (including Cincinnati's obligations to serve Union's full requirements). Union pays for power from the Plants and Cincinnati's other generation assets under a number of long-term agreements, including Cincinnati's Long Term Power Sales Agreement, Rate Schedule FERC No. 56, which the Filing Parties are now requesting to terminate.

6. The Filing Parties explain that the Kentucky Public Service Commission (Kentucky Commission) made clear on a number of occasions, dating back to 2001, that it believes an alternative structure should be adopted to serve load in Kentucky, *i.e.*, that Union should own physical generation assets. The Kentucky Commission expressed concern that reliance on purchased power to serve Union's entire load unduly exposes Union's retail customers to the volatility of market prices. In light of this direction, the Filing Parties agreed to transfer from Cincinnati to Union the Plants, which have a

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[2] *Cinergy Services, Inc., et al.*, 98 FERC ¶ 61,306 (2002).

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combined generating capacity of 1,105 MW. The Filing Parties state that Union will acquire only generating facilities from Cincinnati; Cincinnati will retain all transmission facilities. The Kentucky Commission approved the transfer of the Plants.[3]

7. The PSOA provides the terms and conditions under which the Plants transferred to Union, as required by the Kentucky Commission, will continue to be dispatched as Cincinnati resources under the existing terms of the Joint Dispatch Agreement. The Filing Parties state that the PSOA and the Joint Dispatch Agreement will work on a back-to-back basis to ensure that the transferred Plants will continue to be dispatched in exactly the same manner as they are today. The Filing Parties note that the only things that will change after the transfer are: (1) payment obligations between Cincinnati and Union due to Union's ownership of the plants; and (2) Union's customers now will have first call on the power from the Plants.

8. The Filing Parties state that the PSOA tracks the rates, terms and conditions of the Joint Dispatch Agreement and adopts the same power pricing that was approved in the Joint Dispatch Agreement. Excess energy transferred between the operating companies will be priced at hourly market prices, capped at the receiving party's incremental cost.[4] The Filing Parties note that in hours when the companies do not make hourly transactions, the hourly market price under the agreement would be determined by reference to quotes of hourly energy with similar characteristics offered by nonaffiliated parties. Furthermore, the Filing Parties state that an affiliate sale under the PSOA will be made from a displaceable resource only if a cheaper resource is not available in the market and that they will supply independently audited hourly market price quotes.

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[3] *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, 2003 Ky. PUC LEXIS 1030, at p. 17 (December 5, 2003).

[4] Excess Energy is energy remaining from a company's resources once that company's load requirements have been satisfied. Since no published index of prices exists for this market, the September 27 Filing said that prices would be based on "actual sales quotes of hourly energy with similar characteristics to unaffiliated third parties."

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9. The Filing Parties state that they do not believe that affiliate abuse concerns arise here due to Cinergy's operation as a single system and the minimal effect of the facilities transfer as compared to current sales and purchases. They further assert that, even if the Commission applied *Edgar*,[5] that standard is met.

10. On January 11, 2005, the Director, Division of Tariffs and Market Development - Central issued a deficiency letter in this proceeding. The deficiency letter stated that since the PSOA is a long-term power purchase agreement among affiliates, it is subject to review under the criteria identified in *Edgar*. The Director stated that in order for it to have sufficient information to analyze the filing, the filing parties must submit actual data showing comparable purchase and sale prices that demonstrate that the PSOA pricing meets at least one of the three standards identified in *Edgar*. The letter added that such data should demonstrate that there are sufficient regularly occurring transactions to serve as a market price for the affiliate transactions proposed herein over a representative period, *e.g.*, calendar year 2004.

Filing Parties' Response to Deficiency Letter

11. On January 26, 2005, the Filing Parties filed a response to the deficiency letter, but did not provide the requested data. The Filing Parties maintain that the PSOA is consistent with *Edgar* and that no showing is required. However, the Filing Parties state that, to assuage concerns about the pricing of inter-affiliate transfers of energy under the PSOA, they now commit to defer the effectiveness of the PSOA until the Midwest ISO's Day 2 market[6] becomes effective, currently expected to be April 1, 2005, and they propose to substitute Midwest ISO Day 2 clearing prices for the hourly market price methodology in the PSOA.

12. The Filing Parties aver that adopting Midwest ISO Day 2 market prices to price energy sales under the PSOA complies with the goals of *Edgar*. They state that pricing energy transfers under the PSOA using Midwest ISO Day 2 market prices ensures that ratepayers will not be harmed by the agreement because: (1) "If they are too low or high, costs could be absorbed by captive ratepayers. Here, there is no question that ratepayers

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[5] *Boston Edison Co. Re: Edgar Electric Energy Co.*, 55 FERC ¶61,382 (1991) (*Edgar*) (providing that parties can show that there is no affiliate preference in three ways: (1) evidence of direct head-to-head competition between the affiliate and competing unaffiliated suppliers in a formal solicitation or informal negotiation process; (2) evidence of the prices non-affiliated buyers were willing to pay for similar services from the affiliate; or (3) benchmark evidence that shows the prices, terms, and conditions of sales made by non-affiliated sellers).

[6] Day 2 pertains to the launch of the tested and fully operational Energy Markets.

are fully protected against any possible concerns of affiliate abuse."; (2) the Commission has previously concluded that tying the price of an affiliate transaction to an established, relevant market price adequately mitigates any affiliate abuse concerns;[7] and (3) the Midwest ISO's market prices will be transparent, determined through centrally cleared dispatched markets that are currently operational, and subject to strict market monitoring standards. Moreover, they state that the Commission has repeatedly held that prices for affiliate transactions may be set "by reference to competitive prices at recognized market hubs."[8]

13. In addition, the parties maintain that the PSOA will not harm wholesale competitive markets because: (1) setting the price at the Midwest ISO Day 2 market clearing price provides no incentive to engage in an affiliate sale when less expensive resources are available from non-affiliated suppliers; and (2) the selling affiliate is receiving the same amount of revenues it would receive by selling its energy into the Midwest ISO market, so there is no "safety net" concern.

Discussion

A. Procedural Matters

14. Notice of Union and Cincinnati's September 27, 2004 filing was published in the *Federal Register*, 69 Fed. Reg. 60,386 (2004) with comments due on or before October 18, 2004. None were filed.

15. Notice of Union and Cincinnati's amendment to their September 27, 2004 filing was published in the *Federal Register*, 70 Fed. Reg. 6434 (2005) with comments due on or before February 16, 2005. None were filed.

B. Analysis

16. We will accept the executed PSOA submitted by Union and Cincinnati, subject to the Filing Parties filing, within 15 days of the date of issuance, modifications to the PSOA reflecting the commitments made in their January 26 deficiency letter response. In *Edgar*, the Commission presented three ways that a party can satisfy the affiliate preference standards. We find that the Filing Parties' use of Midwest ISO Day 2 market prices for the PSOA meets the Edgar test and mitigates our concerns regarding transactions between affiliates under the PSOA for the following reasons. First, the price for excess energy sold under the PSOA will be tied to an established and transparent spot

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[7] *See, e.g., Portland General Elec. Co.*, 96 FERC ¶ 61,093 at 61,378 (2001); and *FirstEnergy Trading Servs., Inc.*, 88 FERC ¶ 61,067 at 61,156 (1999).

[8] *See, e.g., Arizona Pub. Serv. Co.*, 101 FERC ¶ 61,028 at P5 (2002).

market price which we find to be an appropriate comparable charge for sales of excess energy as provided for under the PSOA. This will provide the necessary benchmark evidence regarding the price non-affiliated suppliers would pay for similar services. Second, the entire Midwest ISO region will be a single geographic market (consisting of the affiliate and competing unaffiliated suppliers), and market outcomes will be based on the interplay of market forces in that entire region. Third, the PSOA seeks to maintain the existing arrangement between the affiliates under an existing joint dispatch agreement, and does not involve a new solicitation or new build, and no protests were received which leads us to conclude that no other party wanted to make this sale. Finally, we note that the potential for affiliate abuse is limited by the fact that the Filing Parties' transmission assets are subject to the control of the Midwest ISO and cannot be used to impede competition.

The Commission orders:

The Filing Parties' PSOA and rate schedule cancellation are accepted for filing, subject to the filing of a revised PSOA, as discussed in the body of this order. Waiver of section 35.3 of the Commission's regulations is granted to permit the effective date of April 1, 2005.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.