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John J. Finnigan, Jr.
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VIA OVERNIGHT MAIL

December 15, 2005

Ms. Elizabeth O'Donnell
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
P.O. Box 615
Frankfort, Kentucky 40602-0615

Re: 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)
Case No. 2003-00252

Dear Ms. O'Donnell:

Enclosed please find an original and twelve copies of the The Union Light, Heat and Power Company's December 2005 Compliance Filing and Request for Continued Deviation Under KRS 278.2207 and KRS 278.2219 for Commodity Sales and Transportation Services in the above-referenced case.

Please date stamp and return the two extra copies in the enclosed envelope.

Thank you. If you have any questions, please do not hesitate to contact me at (513) 287-3601.

Sincerely,

John J. Finnigan, Jr.
Senior Counsel

JJF/sew
cc: All parties of record (w/encl.)

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 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)	)	Case No. 2003-00252

DECEMBER 2005 COMPLIANCE FILING OF THE UNION LIGHT, HEAT AND POWER COMPANY AND REQUEST FOR CONTINUED DEVIATION UNDER KRS 278.2207(2) AND KRS 278.2219 FOR COMMODITY SALES AND TRANSPORTATION SERVICES

The Union Light, Heat and Power Company ("ULH&P") files the following quarterly status report relating to The Cincinnati Gas & Electric Company's ("CG&E") transfer of three generating stations to ULH&P.[1]

SEC Approval

As ULH&P previously reported to the Commission, the U.S. Securities and Exchange Commission ("SEC") issued an order on November 29, 2005 approving

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[1] The Commission required ULH&P to make quarterly update filings in its June 17, 2005 Order in this proceeding, in which the Commission granted final approval for CG&E's transfer of the plants to ULH&P. *In the Matter of 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)*, Case No. 2003-00252 (Order) (June 17, 2005) (hereinafter "*In re ULH&P Generating Plants*").

CG&E's transfer of these plants to ULH&P.[2] CG&E and ULH&P have now obtained all necessary regulatory approvals for the plant transfer. CG&E and ULH&P have therefore scheduled an effective closing date of January 1, 2006 for the sale of the plants.

Back-up Power Supply Contract

Several changes have occurred since 2003, which have caused CG&E and ULH&P to conclude that the Back-up Power Supply Contract is no longer feasible or necessary. The post-2003 changes include the new FERC standards for approving affiliate power supply contracts; the availability of a reliable supply of power through the MISO Day 2 energy markets; and the FERC limitations on information sharing between regulated and merchant generators. ULH&P will work to address any issues or concerns that the Commission may have associated with back-up power in the near future.

Commodity Supply and Transportation Services

A. Background

On May 10, 2005, ULH&P applied for a deviation from the affiliate pricing rules under KRS 278.2207(2) and KRS 278.2219, to allow ULH&P to purchase and sell coal to CG&E, purchase lime from CG&E, and receive coal and lime transportation services from CG&E, all at fully distributed cost.[3] In ULH&P's September 16, 2005 compliance filing in this proceeding, ULH&P informed the Commission that this request for a deviation would not be necessary for post-January 1, 2006 because Cinergy Corp. is

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[2] *In re ULH&P Generating Plants,* Case No. 2003-00252 (Interim Report of The Union Light, Heat and Power Company Relating to Securities and Exchange Commission Approval) (December 6, 2005).

[3] The Commission's December 5, 2003 Order granted ULH&P a deviation under these statutes for coal purchases from CG&E through the date of its final order approving the transfer of the plants.

separating ULH&P's and PSI's generation and dispatch functions from CG&E's generation and dispatch functions as of January 1, 2006. ULH&P and CG&E initially determined that they would need to obtain their own coal, lime and transportation services.

Based on the foregoing, ULH&P informed the Commission that CG&E would go forward with its original plan to assign existing CG&E coal contracts to ULH&P, and that ULH&P would procure its own coal and lime, and its own transportation services. Since that time, ULH&P has revised its plans for obtaining these commodities and services. ULH&P requests that the Commission issue a ruling that the commodity supply and transportation plan described below complies with the applicable affiliate pricing rules or, in the alternative, ULH&P requests that the Commission grant a deviation from these rules for ULH&P's commodity supply and transportation plan.

A. Coal Supply

1. East Bend

As ULH&P previously informed the Commission, CG&E will assign or split out existing coal contracts for ULH&P. CG&E and ULH&P are finalizing their efforts to identify coal supply contracts which will be assigned or split out to ULH&P. CG&E will assign or split out these contracts to ULH&P as part of the closing for the plant transfer. ULH&P will provide further information to the Commission on these contracts when ULH&P files the final closing documents.

For additional coal supply, and for supply of coal after the existing contracts expire, ULH&P has determined that, in order to have maximum flexibility for procuring

coal, it should be able to source its own contracts and to purchase coal from CG&E under CG&E's coal supply agreements at the contract price for coal. ULH&P could then obtain coal either from third parties at the market price, or from CG&E at CG&E's contract price, if ULH&P determines that this is less than the prevailing market price. This would allow ULH&P to leverage CG&E's economies of scale for the purchase of coal on the Ohio River. ULH&P's customers could benefit from the economies arising from CG&E's much larger scale coal purchasing activity.

ULH&P submits that this pricing complies with KRS §§ 278.2207(1)(b) and 278.2213(6) because the pricing would follow the FERC-approved asymmetrical pricing methodology (at or below market) contained in ULH&P's wholesale market-based rate tariff. ULH&P has enclosed a letter on behalf of Cinergy Services, Inc. to Mr. John S. Moot, FERC's General Counsel, dated December 14, 2005, where Cinergy Services described these coal purchasing plans and other commodity/transportation plans, and requests FERC to issue a no-action letter because these practices comply with ULH&P's FERC-approved asymmetrical pricing methodology. ULH&P will notify the Commission of FERC's response to the no-action letter.

In the alternative, ULH&P requests that the Commission grant a deviation under KRS § 278.2219 to allow ULH&P to enter into such coal purchases and sales with CG&E because compliance with Kentucky's affiliate pricing rule would unreasonably prevent ULH&P from using a coal supply option which could lower costs for customers. Ultimately, ULH&P will not enter into a given purchase or sale with CG&E unless ULH&P deems it prudent to do so. The Commission and interested stakeholders have the right to challenge the prudency of such transactions in ULH&P's fuel adjustment

clause proceedings. For these reasons, and if necessary, the Commission should grant ULH&P a deviation from the affiliate pricing rules for these transactions.

2. Miami Fort 6

ULH&P will also need to purchase coal from CG&E for Miami Fort 6 for the foreseeable future due to site limitations at the Miami Fort Generating Station. Currently, Miami Fort Generating Station has four units in operation: Miami Fort 5, 6, 7 and 8. None of these units currently have scrubbers. A common pile of high sulfur coal serves Miami Fort 5, 6 and 7, while Miami Fort 8 has a separate pile of low sulfur coal. Coal is supplied to these units directly from a barge, or from an on-site coal pile. Miami Fort only has docking and unloading facilities to serve one barge at a time. Based on these limited facilities and the need for coal by all units at the plant, separate shipments of high sulfur coal solely for Miami Fort 6 is not feasible.

At closing, CG&E will sell ULH&P a proportionate share of this high sulfur coal inventory at the weighted average cost of the coal. For future coal pile deliveries, CG&E will continue to sell ULH&P coal at CG&E's weighted average cost. For future barge deliveries, CG&E will sell ULH&P coal at CG&E's cost for that barge shipment.

ULH&P submits that this pricing complies with KRS §§ 278.2207(1)(b) and 278.2213(6) because the pricing would follow the FERC-approved asymmetrical pricing methodology, for the same reasons stated above for the East Bend coal purchases and sales. Further, this pricing is consistent with that set forth in the Miami Fort Unit 6 Operation Agreement previously approved by the Commission.[4]

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[4] *In re ULH&P Generating Plants*, Case No. 2003-00252 (Order at Ordering Paragraph 1) (June 17, 2005).

B. Fuel Oil

CG&E has a single fuel oil contract used to supply fuel oil for all of CG&E's generating plants. The contract is priced at a market index price, but requires the seller to match any lower price which CG&E can obtain. Alternatively, the contract allows CG&E to purchase fuel oil from other sources if it can obtain a lower price. Splitting this contract between CG&E and ULH&P would likely cause the seller to demand a higher price. ULH&P does not believe it could obtain any more favorable pricing terms if it entered into a separate fuel oil contract. ULH&P therefore seeks approval to purchase fuel oil from CG&E at CG&E's fully distributed cost (which, pursuant to the fuel oil contract, would be at or less than market).

ULH&P submits that this pricing complies with KRS §§ 278.2207(1)(b) and 278.2213(6) because the pricing would follow Kentucky's affiliate pricing rules (lower of cost or market) and the FERC-approved asymmetrical pricing methodology. In the alternative, ULH&P requests that the Commission grant a deviation under KRS § 278.2219 to allow ULH&P to buy fuel oil from CG&E at cost, for the reasons stated above.

C. Transportation Services

CG&E has contracts for the transportation of coal and lime to its generating facilities. CG&E attempted to split out the coal transportation contract to ULH&P, but the counterparty requested higher prices to do so. CG&E and ULH&P therefore propose that CG&E will provide coal and lime transportation service to ULH&P under these

existing contracts, at CG&E's cost. ULH&P believes that this would be less expensive than if ULH&P enters into new contracts with third parties. As these existing transportation contracts expire, ULH&P will determine whether it is more economical to continue purchasing transportation services from CG&E at cost, or to enter into independent contracts. For the reasons stated above, ULH&P submits that this complies with ULH&P's FERC-approved asymmetrical pricing methodology. In the alternative, ULH&P requests that the Commission grant a deviation under KRS § 278.2219 to allow ULH&P to buy coal and lime transportation services from CG&E at cost.

D. Lime Supply

ULH&P has determined that it can split out the CG&E Lime Supply Agreement for East Bend without any additional costs, and is taking steps to do so effective January 1, 2006.

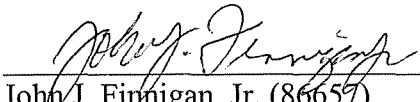
E. Parts Supply

ULH&P has not addressed this topic in prior filings, but now requests approval to buy parts from CG&E at cost for Miami Fort 6. As stated above, CG&E currently operates four generating units at the Miami Fort plant. CG&E maintains a common inventory for these plants. ULH&P believes it would be more economical for it to purchase parts from CG&E at CG&E's cost, as compared to ULH&P maintaining a separate inventory of parts it purchases from third parties for use at this plant. ULH&P submits that these parts are generally consumed within a reasonably short time after purchase, and the market price does not vary greatly, such that CG&E's cost is generally

equivalent to the market price. As such, this complies with Kentucky's affiliate pricing rules and the FERC-approved asymmetrical pricing methodology. Further, this pricing is consistent with that set forth in the Miami Fort Unit 6 Operation Agreement previously approved by the Commission.[5]

WHEREFORE, ULH&P hereby submits this compliance filing as required by the Commission's June 17, 2005 Order. ULH&P requests that the Commission issue a ruling that the transactions proposed herein comply with KRS §§ 278.2207(1)(b) and 278.2213(6). In the alternative, ULH&P requests that the Commission grant a deviation under KRS § 278.2219 to allow ULH&P to enter into these transactions.

Respectfully submitted,



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[5] *In re ULH&P Generating Plants*, Case No. 2003-00252 (Order at Ordering Paragraph 1) (June 17, 2005).

CERTIFICATE OF SERVICE

I hereby give notice that on this 15th day of December, 2005, I have served a copy of the foregoing December 2005 Compliance Filing of The Union Light, Heat and Power Company and Request for Continued Deviation Under KRS 278.2207(2) and KRS 278.2219 for Commodity Sales and Transportation Services on the parties listed below by overnight delivery.

John J. Finnigan, Jr.

Elizabeth E. Blackford
Assistant Attorney General
Office of Rate Intervention
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SYDNEY
TOKYO
TORONTO
VIENNA

December 14, 2005

John S. Moot
General Counsel
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, DC 20426

RE: No-Action Letter Request on Behalf of Cinergy Services, Inc.

Dear Mr. Moot:

We are writing pursuant to section 388.104(a) of the Commission's regulations and the Commission's recent *No-Action Order*[1] on behalf of Cinergy Services, Inc. ("Cinergy Services"), The Cincinnati Gas & Electric Company ("CG&E"), PSI Energy, Inc. ("PSI") and the Union Light, Heat and Power Company ("ULH&P") (collectively "Cinergy") regarding the consistency of proposed operations and practices of Cinergy described herein with the Cinergy Codes of Conduct contained in the Cinergy market-based rate tariffs ("MBR Tariffs"). We request a response that you or your designee will not recommend enforcement action if Cinergy implements its operations and practices as described herein.[2] Cinergy plans to implement these practices beginning January 1, 2006, and thus we respectfully request expedited attention to this letter.

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1 18 C.F.R. § 388.104(a) (2005); *Informal Staff Advice on Regulatory Requirements*, 113 FERC ¶ 61,174 (2005) ("*No-Action Order*").

2 The Commission initially is limiting no-action inquires to questions related to certain matters, including the Market Behavior Rules, contained in MBR Tariffs. *No-Action Order* at P 8. The questions herein relate to the Codes of Conduct contained in Cinergy's MBR Tariffs. Market Behavior Rule 6 requires compliance with the Codes of Conduct.

I. Description of Cinergy

Cinergy Corp. is a registered holding company under the Public Utility Holding Company Act of 1935, as amended ("PUHCA"). Cinergy was created as a result of the 1994 merger of CG&E and PSI. CG&E is a combination electric and gas public utility that provides service in the southwestern portion of Ohio. CG&E is subject to Ohio's electric utility restructuring statute which initiated retail competition in Ohio starting in 2001. PSI is a vertically-integrated, regulated electric utility that provides service across north central, central, and southern Indiana. ULH&P is a natural gas and electric utility serving customers in Greater Cincinnati's Northern Kentucky communities, and is wholly owned by CG&E. ULH&P offers only bundled retail sales of natural gas supply and delivery, and electric distribution and transmission services and, as described below, soon will own generation. In addition to this Commission, CG&E is regulated by the Public Utilities Commission of Ohio, PSI is regulated by the Indiana Utility Regulatory Commission, and ULH&P is regulated by the Kentucky Public Service Commission ("KPSC"). Cinergy Services is a service company that provides Cinergy's subsidiaries with a variety of centralized administrative, management, and support services.

II. Background

In its November 22, 2005 order in *Cincinnati Gas & Elec. Co.*, 113 FERC 61,197 (the "*Code of Conduct Order*"), the Commission approved a series of tariff filings that, among other things, amended (or created) the Codes of Conduct of the applicants to allow CG&E to operate on the same side of the Code of Conduct "wall" as its marketing affiliates. In its filing in that proceeding, Cinergy informed the Commission that it plans to terminate the Joint Generation Dispatch Agreement ("JGDA") between CG&E and PSI and the Purchase, Sale and Operation Agreement ("PSOA") between CG&E and ULH&P on January 1, 2006, and move CG&E to the other side of the Code of Conduct wall, so that CG&E now will be separated from its franchised utility affiliates, PSI and ULH&P, by a Code of Conduct effective on that date. Filing Letter, Docket No. ER05-1366-000 *et al.*, at pp. 2, 4, dated August 19, 2005 ("August 19th Filing").

As discussed below, CG&E soon will transfer certain generation units to ULH&P. Following the transfer, CG&E and ULH&P will own generation units located at the same generation site ("Miami Fort"). In the August 19th Filing that resulted in the *Code of Conduct Order*, Cinergy stated that it would make "a separate filing with the Commission in the event that the sharing of a generation site would require a limited code of conduct waiver." August 19th Filing at p. 7 n.13. For the reasons discussed below, Cinergy believes that a waiver should not be required

because the sharing of the generation site and the other arrangements described herein will not be inconsistent with the Code of Conduct.

III. Discussion

In preparation for implementation of its Code of Conduct reorganization following the termination of the JGDA and PSOA, Cinergy has conducted due diligence to determine where changes in operations or systems will be required to reflect the new Code of Conduct separation between PSI/ULH&P and CG&E. In most cases this analysis was relatively straightforward and Cinergy is in the process of implementing appropriate safeguards. In a few instances technical application of the Code of Conduct was unclear, as described below. In interpreting the Code of Conduct rules and whether the practices described herein are consistent with those rules, the Commission should consider that the practices described herein will not harm any captive ratepayers of Cinergy (*i.e.*, the ratepayers of PSI[3] and ULH&P). Therefore the purpose of the Code of Conduct will not be undermined by allowing the arrangements. *See, e.g., Carolina Power & Light Co.*, 97 FERC ¶ 61,063, at 61,350 (2001) (the purpose of the Code of Conduct is to prevent the affiliates from acting in a manner that results in a transfer of benefits from the franchised utility and its ratepayers to the power marketer and its shareholders).

A. Miami Fort Operations

In the near future CG&E expects to transfer to ULH&P a generating station located at the same common Miami Fort site with other generation, some owned by CG&E and some owned jointly by CG&E and Dayton Power & Light Company ("Dayton").[4] When the new Code of Conduct provisions between CG&E and

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[3] None of the issues discussed herein affect PSI; thus, this letter discusses the affect of the planned practices and operations on ULH&P only.

[4] In addition to the 168 MW (nameplate rating) Miami Fort 6 coal-fired unit, CG&E is transferring to ULH&P on January 1, 2006, the 447 MW (nameplate rating) coal-fired East Bend Generation Station and the 490 MW (nameplate rating) combustion-turbine Woodsdale Generation station. CG&E jointly owns the East Bend unit with Dayton; following the transfer of CG&E's ownership share in East Bend to ULH&P, East Bend will be owned 69% by ULH&P and 31% by Dayton. The KPSC authorized the transfer, finding it "in the best interest of ULH&P and its ratepayers." *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 2. The transfers will

ULH&P take effect on January 1, 2006, some employees at the site will be shared employees trained to observe the "no-conduit rule," so that they will not provide CG&E with information about the status of the ULH&P unit.[5] However, an issue arises as to whether some information, described below, about the site that would go to both parties should be considered market information under the Code of Conduct.

For example, the site has a single interconnection with the grid, and if the interconnection facilities are out of service, CG&E will know not only that its own units cannot deliver power to the grid, but that the other units at the Miami Fort site also cannot deliver power to the grid, including the units at the Miami Fort site that CG&E co-owns with Dayton. CG&E will not receive any information that relates solely to the unit of its affiliate, ULH&P. Given that CG&E has several units at the site as compared to ULH&P's one unit, any "joint" status event, such as an interconnection outage, would affect CG&E at least as much as ULH&P, and CG&E would not be in a position to somehow disadvantage ULH&P's ratepayers even if it wanted to do so.

CG&E currently has such information of "joint" status events for Dayton, a non-affiliate. Possessing such information with respect to ULH&P will no more harm ULH&P's ratepayers than it will Dayton's ratepayers.[6] Access to such joint information is a necessary and normal incident to joint ownership of a site or a facility. CG&E believes that the joint status information CG&E may receive regarding ULH&P's units at the Miami Fort site should be viewed as CG&E's own information -- or at least "jointly owned" information -- that would not violate the Code of Conduct. However, recognizing that there is an ambiguity here, Cinergy seeks confirmation that enforcement action would not be recommended to the extent CG&E's access to such "joint" information is necessary given the joint site ownership arrangement. Cinergy is not requesting such a confirmation with respect to market information that pertains solely to ULH&P's unit, which will be subject to

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not include step-up transformers or other transmission facilities, which will continue to be owned by CG&E.

[5] Such shared employees will be on-site (or traveling between similar sites) and will not be located on the trading floor or engage in economic decisions regarding plant dispatch. *Compare Florida Power Corp.*, 111 FERC ¶ 61,243 (2005) (Staff expressed concern about sharing of certain generation employees); *cf. also* 18 C.F.R. §358.4(a)(4) (permitting sharing of "field and maintenance" employees under similar requirements of Standards of Conduct).

[6] ULH&P's generation and load both are located in the MISO market. ULH&P therefore always can serve its load at market prices. Moreover, any outage of the interconnection facility that affects the availability of generation at the site would be reported to MISO.

the no-conduit rule and will not be provided to CG&E employees who are not shared.

B. Joint Purchases of Non-Power Goods and Services

With the transfer to ULH&P of CG&E generating units, ULH&P will require coal, fuel oil, lime and other non-power goods (*e.g.*, repair/maintenance parts) to operate its facilities. CG&E, as the long-time owner/operator of these generation units, has entered into long-term supply and transportation contracts for coal, fuel oil and lime for these facilities. In the specific cases described below, Cinergy plans to have CG&E be the joint purchaser of the non-power goods or services for both itself and ULH&P. CG&E is unlikely to suffer any harm if ULH&P does not obtain these goods and services through CG&E. However, ULH&P may be harmed if it does not obtain these goods and services through CG&E because ULH&P is not likely to receive prices and other terms that are as favorable due to the fact that ULH&P has much smaller purchasing requirements compared to CG&E. As explained below, two Code of Conduct issues may arise in connection with these joint purchases - pricing of non-power goods and services and the sharing of market information.

1. Pricing Issues

a. Coal

CG&E has a "coal pile" at the Miami Fort site used to fuel the generation units located at the site. The purpose of maintaining a coal pile is to provide a ready, on-hand supply and to smooth volatility in spot market prices. The coal in the coal pile was procured to serve the units at the Miami Fort site, including the unit being transferred to ULH&P.[7] At the time CG&E transfers the generation units to ULH&P it also will transfer to ULH&P a share of the Miami Fort coal pile inventory proportionately equal to the size of the generation unit being transferred to ULH&P relative to the size of the total units owned by Cinergy at the Miami Fort site. CG&E will transfer this portion of the coal pile to ULH&P at the weighted average cost of coal in the pile. The transfer will occur effective January 1, 2006.

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[7] At the Miami Fort site, CG&E owns three coal units; CG&E owns 100% of Unit 5 (80 MW) and CG&E co-owns with Dayton Units 7 and 8 (each 500 MW units; CG&E owns 64% of Units 7 and 8, or 320 MWs of capacity at each unit.). CG&E also owns four fuel oil-fired combustion turbines, with an aggregate capacity of 78 MW, at Miami Fort Station. CG&E's Unit 6 is being transferred to ULH&P (*see infra* note 4). The coal pile contains high sulfur coal and is used to serve units 5-7 at Miami Fort. In addition, there is a separate coal pile of low sulfur coal that is used for Unit 8, which CG&E and Dayton co-own.

Historically, CG&E has purchased coal to serve all units at the Miami Fort site, including purchasing coal on behalf of Dayton. On a going forward basis, Cinergy plans to have CG&E continue to make coal purchases for all units at the Miami Fort site, including the unit being transferred to ULH&P. The configuration of the Miami Fort site is not conducive to separate coal deliveries. The Miami Fort site has one barge handling facility to unload coal delivered to the site. The majority of coal is delivered directly from a barge to the generation units. Given the amount of coal needed to fuel the generation units located at the Miami Fort site, barge unloading often is a 24-hour per day operation. Due to the limited coal delivery capacity, it would be difficult, if not impossible at certain times, to coordinate separate coal deliveries for CG&E and ULH&P. Further, an entire barge delivery likely would not be needed to fuel the relatively small size of the Miami Fort unit being transferred to ULH&P. As a result, if ULH&P were to purchase coal on its own behalf, it most likely would need deliveries of less than a full barge, making deliveries on a per ton basis uneconomic.

The majority of coal consumed by the generation units is delivered from a barge to a conveyor belt system that feeds coal directly to the Miami Fort generation units. The coal pile is utilized as an on-hand source of coal in cases where direct delivery from a barge is not feasible. Cinergy plans to have CG&E procure coal on behalf of itself and ULH&P for all future coal purchases to serve the Miami Fort units to maximize economies of scale, as CG&E does currently for Dayton. CG&E operates a much larger generation fleet than ULH&P, including more units and larger units at the Miami Fort site;[8] thus, CG&E is able to capture efficiencies and economies of scale that ULH&P might not obtain if required to purchase its own coal. ULH&P can benefit by having CG&E purchase additional coal and sell coal to ULH&P as needed at CG&E's procurement cost. For coal delivered directly from a barge to ULH&P's unit, CG&E will charge ULH&P the price paid by CG&E for the coal on such barge. This is consistent with the Commission's asymmetrical pricing rules because ULH&P will be charged the market price for the coal that CG&E negotiated with third-party suppliers. As discussed further below, the Code of Conduct refers to a "market" price but does not define what constitutes a market price. Cinergy submits that the price under a long-term contract with a third party constitutes a market price.

Coal will be added to the shared Miami Fort coal pile at CG&E's procurement cost. The shared coal pile has a single weighted average cost. All coal transferred from the pile for use in generating units is transferred-out at the same weighted average cost, whether it is delivered to a wholly-owned CG&E unit, a

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[8] *See supra* note 7.

CG&E unit jointly owned with Dayton, or the unit to be owned by ULH&P. This is consistent with the Commission's "asymmetrical pricing" requirement for two reasons. First, CG&E acquires the coal at a market price (*i.e.*, negotiated with third-party coal suppliers); ULH&P will receive its proportionate share of the coal purchases at that same price. Second, CG&E allocates cost of the same coal pile to Dayton at the same weighted average cost price. Because a non-affiliate is buying coal at the same price, this should be viewed as an acceptable proxy for a market price. As described above, there are significant benefits to having an on-site coal pile, and CG&E, Dayton and ULH&P (and therefore their ratepayers) all benefit from the efficiencies and economies of scale inherent in a single coal pile.

The East Bend Generation Station (a 447 MW (nameplate rating) coal-fired unit, *see supra* note 4) is another CG&E unit being transferred to ULH&P; the transfer will occur effective January 1, 2006. On that date, CG&E will cease purchasing coal for East Bend and ULH&P will commence purchasing coal from the same third party suppliers. For future coal purchases, ULH&P may request CG&E to procure coal on its behalf for delivery at East Bend to take advantage of CG&E's economies of scale. For such coal, ULH&P would pay CG&E's procurement cost (*i.e.*, the contract price, which is the market price at the time CG&E enters into such agreements). However, ULH&P will have the option of securing its own coal contracts, should it find coal cheaper elsewhere. As discussed above, because CG&E operates a much larger generation fleet than ULH&P, CG&E may be able to capture efficiencies and economies of scale that ULH&P could not obtain if required to purchase its own coal. Thus, ULH&P could benefit by having the option of purchasing designated coal from CG&E as it deems prudent at CG&E's procurement cost. However, as explained below, if ULH&P chooses to have CG&E purchase coal on its behalf, ULH&P should be considered committed to taking coal under the CG&E secured coal contract for the duration of the contract.

The Code of Conduct does not define what constitutes a "market" price. Here, at the time CG&E enters into a long-term coal contract with a third party, such a contract will represent the market price. In evaluating the market price in subsequent years, the Commission should consider whether the contract price reflected a market price at the time the contract was entered into. For example, assume CG&E can procure coal on its own behalf and on behalf of ULH&P for purposes of meeting the coal requirements of ULH&P's East Bend unit at a price of $45/ton for 5 years, and that ULH&P finds this to be an economically prudent purchase and decides to have CG&E procure its coal at $45/ton. Further assume that, two years later, the price for coal in the market drops to $40/ton. It would be inequitable to allow ULH&P to abandon its decision to have CG&E purchase its coal under the 5-year contract. In other words, the Commission should not compare committed long-term contract prices to current market prices when evaluating

whether the price paid by an affiliate is no higher than market. Doing so would shift too much risk to CG&E, resulting in a disincentive to CG&E sharing any coal procurement economies with ULH&P.

b. Fuel Oil

CG&E has a single contract to procure fuel oil for all of its generating stations ("Fuel Oil Contract"), including those to be transferred to ULH&P. Fuel oil is used for unit start-up and for heavy equipment at the sites. The CG&E Fuel Oil Contract is priced at a market index, but where CG&E is able to procure fuel oil at less than this indexed price, the supplier must match such below-index price or permit CG&E to purchase fuel oil from the alternative source. Thus, the Fuel Oil Contract is priced at or below market, consistent with the asymmetrical pricing rules in the Code of Conduct. Cinergy believes that an attempt to "split" the Fuel Oil Contract into two contracts for each of CG&E and ULH&P could result in renegotiation and loss of favorable price terms. CG&E proposes to continue the contract and sell ULH&P fuel oil for its facilities at the price provided in the Fuel Oil Contract. This is consistent with the asymmetrical pricing rules because the price will be equal or less than the market index.

c. Transportation

CG&E has a contract for barge transportation of coal and a contract for barge transportation of lime to its facilities on the Ohio River, including Miami Fort and East Bend.[9] Cinergy plans to have CG&E utilize these contracts to transport coal and lime for ULH&P at the price CG&E pays under such contracts. As discussed above, it is not workable for ULH&P to have separate coal deliveries to the Miami Fort site. While ULH&P could attempt to procure separate transportation contracts for the transportation of coal and lime to East Bend, due to economies of scale enjoyed by CG&E, it likely would cost ULH&P more to enter into stand-alone contracts for coal and lime transportation.[10] Also, these contracts were negotiated based on the need to deliver coal to CG&E's entire fleet of generating stations and lime to its scrubbed units, including the units being transferred to ULH&P. CG&E's

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[9] The units at Miami Fort do not require lime and, as such, no lime is delivered to the Miami Fort site. ULH&P independently will procure lime for the East Bend generation unit, the only unit being transferred to ULH&P that requires lime.

[10] CG&E attempted to renegotiate its coal transportation contract to split it between CG&E and ULH&P, but the counterparty quoted CG&E and ULH&P higher transportation rates to do so.

procurement costs under these third-party supplier agreements reflect market price and should satisfy the asymmetrical pricing rule.

d. Parts Supply

Similarly, CG&E maintains non-power goods on-site at the Miami Fort site (as well as other sites) to provide a ready, on-hand supply of necessary parts. Currently, the transfer of these non-power goods from CG&E to ULH&P occurs at average cost, which is a weighted calculation based on the previous average and the latest purchase. CG&E proposes to continue to transfer to ULH&P non-power goods for its facilities at average cost. Cinergy believes this continued arrangement will benefit ULH&P. As noted above, CG&E operates a much larger generation fleet than ULH&P, including more units at the Miami Fort site; thus, CG&E is able to capture efficiencies and economies of scale that ULH&P could not obtain if required to purchase its own supply of non-power goods and its own inventory. ULH&P, were it to create its own inventory, would need to create a large inventory of parts that are necessary to have on hand but would be used infrequently for its small generating fleet. By sharing with CG&E, it receives the benefit of a parts inventory created for a much larger generation fleet, with more rotation of parts. Moreover, the average cost calculation is consistent with the Commission's asymmetrical pricing requirement as the "cost" to ULH&P continues to be based on the average market price of the non-power goods.

2. Information Sharing Issues

Effective January 1, 2006, the Codes of Conduct prohibit PSI/ULH&P from sharing market information with CG&E unless such information is simultaneously made available to the public. Because CG&E will purchase the above-described non-power goods and services, CG&E will know the price of these goods and services consumed by ULH&P. Arguably, under the Commission's broad definition of market information, the price of coal, fuel oil and transportation services could be considered market information. However, it is *CG&E's* market information as well as ULH&P's because it relates to goods and services purchased and consumed by CG&E, and to the price received by CG&E from ULH&P. Moreover, some of this information subsequently is made public in reports submitted to FERC. For example, in FERC Form No. 423, Cinergy reports coal and fuel oil delivered to particular generation sites; these costs include transportation costs.

Cinergy submits that any sharing of market information that occurs here does not warrant a Commission enforcement action because, as described above, these arrangements benefit ULH&P's ratepayers. In each case, the arrangement is a historic arrangement associated with service to the ULH&P plants. ULH&P is

acquiring those plants, pursuant to a KPSC order finding that the acquisition will benefit ratepayers. The limited continuing relationships described above enhance the efficiencies of the asset transfer. Since ratepayer protection is the purpose of the Code of Conduct, initiation of an enforcement action to end these relationships would undermine such efficiencies, and would be contrary to the underlying purpose of the rules.

IV. Conclusion

For the above-stated reasons, we request a response that you or your designee will not recommend enforcement action if Cinergy implements its practices and operations as described herein. Again, in interpreting the Code of Conduct rules and whether the practices described herein are consistent with those rules, the Commission should consider that the practices described herein will not harm any captive ratepayers of Cinergy. Therefore the purpose of the Code of Conduct will not be undermined by allowing the arrangements.

As required by the *No Action Order* (113 FERC ¶ 61,174 at P 11), attached hereto is a statement verifying the accuracy of the contents of this letter. If you have any questions or require any additional information regarding this request, please contact me at (202) 371-7878.

Very truly yours,

Mary Margaret Farren

Mary Margaret Farren
Attorney for Cinergy Services, Inc.

Attachment to
December 14, 2005 No Action Request Letter to John S. Moot

Statement of Accuracy

I, DIEGO A. GÓMEZ, state that that I am Senior Counsel of Cinergy Services, Inc. I have read the foregoing letter and to the best of my personal information, knowledge and belief, the request is accurate and complete and does not contain any untrue statement of a material fact, that there is no omission of a material fact in the request, and that the request does not raise any issue that relates to the merits of an on-the-record proceeding currently before the Commission.

Diego A. Gómez

District of Columbia

Subscribed and sworn before me
This 14th day of December, 2005:

Notary Public

My Commission expires on: 6-30-2009