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VIA OVERNIGHT MAIL

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October 29, 2004

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

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PUBLIC SERVICE COMMISSION

Re: Case No. 2004-00253

Dear Ms. O'Donnell:

Enclosed please find an original and ten (10) copies of ULH&P's Reply Comments to the Comments of the Attorney General, for filing in the above-referenced case. Please return to me one (1) file-stamped copy in the enclosed overnight mail envelope. Should you have any questions, please do not hesitate to contact me at (513) 287-3075.

Sincerely,

Michael J. Pahutski

Michael J. Pahutski

MJP/mak

Enclosures

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PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of the Application of The Union Light, Heat and Power Company for Economic Development Tariffs	)))	Case No. 2004-00253

THE UNION LIGHT, HEAT AND POWER COMPANY'S REPLY COMMENTS TO THE COMMENTS OF THE ATTORNEY GENERAL

The Union Light, Heat and Power Company (ULH&P) submits these comments in reply to the comments filed by the Kentucky Attorney General (AG) in the above-captioned proceeding (AG's Comments). ULH&P believes that the AG's Comments demonstrate a misunderstanding of ULH&P's proposed economic development tariffs, and more fundamentally espouse a policy that may very well frustrate economic development in Northern Kentucky.

The AG professes to oppose all economic development rates, preferring instead that utilities offer no such discounts to customers.[1] The AG neglects to recognize the Commonwealth's express desire to promote economic development. The Commonwealth of Kentucky, for example, has developed an entire economic development system, the mission of which is to:

> achieve the best quality of life for all Kentuckians through long-term strategic planning and implementation that fosters sustainable growth in jobs and incomes and enables communities, businesses,

[1] *See* AG's Comments at 2.

> governments, and individuals to compete in the global marketplace.[2]

To meet this mission, the General Assembly created the Kentucky Economic Development Partnership, a board governing the Cabinet for Economic Development whose purpose is to improve and promote the health and general welfare of the people of the Commonwealth through sustainable economic development.[3] It is in this spirit of progressive economic development that ULH&P proposed its economic development tariffs.

In fact, ULH&P's economic development tariffs fit nicely within the Commonwealth's framework for economic development, closely aligning with the goals of Kentucky's Enterprise Zone Program. The General Assembly's stated purpose of the Enterprise Zone Program is to revitalize economically depressed areas of the state, seeking to:

> (1) Improve the quality of life of individuals that reside within an enterprise zone by providing employment opportunities, job training, and neighborhood improvement programs;
>
> (2) Encourage economic activity by assisting and maintaining existing business within an enterprise zone;
>
> (3) Encourage economic activity by stimulating the influx of new business within an enterprise zone; and
>
> (4) Eliminate blighted and deteriorated areas within an enterprise zone that feature chronic abandonment or demolition of residential or commercial structures or property.[4]

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[2] KRS 154.01-020.

[3] KRS 154.10-010.

[4] KRS 154.45-001.

ULH&P notes that its Rider ED aims to increase employment opportunities; its Rider UR is intended to revitalize urban areas where serviceable buildings have been abandoned or otherwise left unoccupied; and ULH&P's Rider BR is intended to foster development of brownfield sites. With ULH&P's proposed economic development tariffs so closely aligned with Kentucky's goals of fostering economic development, and helping to realize the concomitant benefits designed to flow to residents of the Commonwealth, it is difficult to understand why the AG so adamantly opposes these programs.

This is particularly curious where the AG admits that ratepayers are likely to receive indirect benefits from ULH&P's economic development tariffs.[5] Of course, the Company, the AG, and the Commission cannot quantify with 100% accuracy the costs and benefits of ULH&P's economic development program until the Company is able to get its tariffs in place and promote their incentives to prospective businesses. Only after ULH&P has a few such customers under its belt can specific benefits and costs be quantified. As ULH&P stated in its responses to the Staff's and AG's data requests, the parties to ULH&P's next rate case proceeding will have ample opportunity to argue the merits of the program and the extent and impact of any revenue short-fall on the various customer classes.[6]

ULH&P is willing to risk non-recovery of such revenue short-fall to meet its civic responsibility for the benefit of the Commonwealth and its citizens. The AG, as the designated public representative of residential customers, who are sure to benefit from

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[5] *See* AG's Comments at 2.

[6] *See The Union Light, Heat and Power Company's Responses to Commission Staff's First Data Request*, no. 4; *The Union Light, Heat and Power Company's Responses to Initial Requests for Information from the Attorney General*; no. 20.

job creation, urban renewal and revitalization of their communities, should more closely consider these potential benefits, rather than arguing against these tariffs at the outset before hard data is available. With ULH&P's economic development program so perfectly aligned with the Commonwealth's goals, the AG should encourage ULH&P's shareholders to accept this risk of non-recovery, with the knowledge that the potential benefits to its constituents could be very great. The AG will have the opportunity to protect the interests of residential ratepayers, should such benefits prove illusory, in ULH&P's next general rate case proceeding, when hard data is available. The AG has little to lose, and potentially much to gain, on behalf of his constituents in supporting ULH&P's economic development tariffs.

The AG further argues that discounts on electric rates related to economic development were not contemplated by the General Assembly, citing KRS 278.170's lack of reference to economic development.[7] While the AG correctly cites this statute, he fails to cite a single statute expressly prohibiting discounts for purposes of economic development. Surely, the General Assembly intended to allow the Commission to consider matters such as economic development in the formulation of rates, where it states:

> (3) Every utility may employ in the conduct of its business suitable and reasonable classifications of its service, patrons and rates. The classifications may, in any proper case, take into account the nature of the use, the quality used, the quantity used, the time when used, the purpose for which used, and *any other reasonable consideration*.[8]

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[7] *See* AG's Comments at 2.

[8] KRS 278.030.

Given the Commonwealth's expressed interest in economic vitality, *supra*, the General Assembly cannot have meant that due consideration to economic development in setting rates is not a "reasonable consideration."

On another of the AG's points, the AG errs when he states that two of the three ULH&P proposed economic development tariffs provide for a 50% reduction of the total bill, and neither cover marginal variable costs nor contribute to fixed costs.[9] First, Rider ED and Rider UR, presumably the two tariffs referred to by the AG, contemplate a 50% reduction of charges *other than rate adjustment riders*, such as the fuel adjustment clause. This is an important point, in that fuel comprises a large portion of the variable marginal cost billed to customers, and fuel adjustment charges are specifically omitted from the discounted charges. Second, setting aside fuel adjustment charges, fixed costs typically comprise more than 50% of the remainder of a customer's charges (recognizing that customers with extremely high load factors may see more than 50% of their bill comprised by kWh charges). As such, the 50% reduction granted to customers under Rider ED and Rider UR is actually a reduction in the demand charges associated with ULH&P's fixed costs. Variable costs would be fully covered by the 50% paid by customers, with some left over as a contribution to fixed costs.

The AG also argues that the increasing load incurred as a result of new customers taking service under one of ULH&P's economic development tariffs would result in an increase in the average fuel price paid by all customers.[10] While this could occur during peak periods, such as summer days, any increase in the average cost of fuel should be more than offset by the increased contribution to fixed costs from customers who might

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[9] *See* AG's Comments at 2.

[10] *Id.* at 3.

otherwise not have relocated to ULH&P's service territory. And these contributions to fixed costs will continue, indeed will increase, after the customer's discount period terminates.

The AG again errs in asserting that "(t)here is no provision in any of the tariffs for the recovery of customer-specific costs."[11] In fact, none of ULH&P's proposed economic development tariffs provide for discounting of customer-specific costs. Rider BR provides for a discount only off of the demand charge, and Rider UR specifically states that "... the requested service necessary to serve the new load must not result in additional investment in distribution or transmission facilities by the Company ..." Customer-specific costs are recovered via the underlying standard rate schedule. The AG has simply misinterpreted ULH&P's proposed tariffs.

Likewise, the AG has misread ULH&P's Rider ED where he states, "There is nothing to prevent free-riders or to allow the Kentucky Economic Development Cabinet to comment on whether discounted rates should be accorded to those who would seek service under the proposed tariff."[12] ULH&P's proposed Rider ED specifically states:

> To qualify for service under this Rider, the customer must meet the qualifications as set forth below. Further, the customer must have applied for and received economic assistance from the State or local government or other public agency before the Company will approve a Service Agreement under this Rider.

Clearly, oversight of the economic development process by the Commonwealth is adequately provided for in ULH&P's Rider ED.

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[11] *Id.* at 4

[12] *Id.*

In concluding, ULH&P again urges the Commission to approve its proposed economic development tariffs, Rider ED, Rider BR and Rider UR. Contrary to the AG's assertions,[13] it is highly likely that these tariffs will promote the long-term economic vitality of Northern Kentucky. By being able to offer specific, well-designed programs, ULH&P can offer prospective businesses considering locating in Northern Kentucky some level of certainty in terms of available economic incentives. These programs surely are aligned with the Commonwealth's economic development initiatives, and are certain to provide benefits to all those living and working in Northern Kentucky.

Dated at Cincinnati, Ohio, this 29th day of October, 2004.

THE UNION LIGHT, HEAT AND
POWER COMPANY

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[13] *Id.* at 4

CERTIFICATE OF SERVICE

I hereby give notice that on this 29th day of October, 2004, I have filed an original and 10 true copies of the foregoing Reply Comments with the Kentucky Public Service Commission at 211 Sower Boulevard, Frankfort, Kentucky, 40601 and have served a copy of the foregoing Reply Comments on the parties by regular U.S. mail or overnight mail to the parties appearing below.

Michael J. Pahutski

Michael J. Pahutski

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