

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

In the Matter of:

MAY 31 2005

PUBLIC SERVICE  
COMMISSION

APPLICATION OF THE UNION LIGHT, HEAT AND )  
POWER COMPANY FOR APPROVAL OF )  
MODIFICATIONS TO ACCOUNTING PRACTICES )  
TO ESTABLISH REGULATORY ASSETS AND ) CASE NO. 2005-00096  
LIABILITIES RELATED TO CERTAIN )  
MISO-RELATED COSTS AND REVENUES NOT )  
ALREADY INCLUDED IN EXISTING BASE RATES )

COMMENTS OF THE ATTORNEY GENERAL

Pursuant to the procedural order issued April 11, 2005, the parties are to file written comments or to request a formal hearing no later than May 31, 2005. These are the comments of the Attorney General. No formal hearing is requested.

The request of Union Light, Heat and Power Company to establish regulatory assets and liabilities for MISO related costs and revenues not already included in base rates should be denied. The MISO related increase in transmission expense is for a service currently being provided. It is not extraordinary in nature and it is not a material cost increase. It is not a non-recurring expense. Most importantly, deferring these costs for recovery in a rate case filed after December 2006 would circumvent the settlement agreement limitation on rate increases that limits the Company's right to bring a rate case pertaining to increases in transmission expense under an \$8 million floor through December 31, 2006.<sup>1</sup> Ignoring that settlement agreement

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<sup>1</sup> *In the Matter of: The Application of the Union Light, Heat and Power Company for Certain Findings Under 15 U.S.C. § 79Z, Case Number 2001-058, settlement discussed and accepted as reasonable by Order dated May 11, 2001. The settlement entered in this case resolved matters pending in three separate cases, the one first referenced and Cases Numbered 2000-517 and 2000-426. Respectively, the styles of those cases are In the Matter of the Examination by the Public Service Commission of the Application of the Fuel Adjustment Clause of the Union Light,*

would deprive the ratepayers of the benefit of that bargain without reason. Therefore, the request to create regulatory assets and liabilities should be denied.

The complex settlement agreement entered into and approved in Case No. 2001-00058, limits the right of ULH&P to seek a rate increase relating to increased transmission and distribution expenses through December 31, 2006, without facing an imputed \$8 million increase in revenues. If ULH&P is allowed to defer the MISO related expenses, ratepayers will lose the benefit of that bargain because the increased costs incurred will be deferred for recovery past the point when the increased costs would be offset by imputed revenues, and when, as appears to be the case here, a rate increase to recover the costs before December 31, 2006, would not otherwise be sought.

Even if there were not an approved settlement agreement to prevent the treatment sought here, the MISO-related transmission cost increases do not warrant deferral. The Commission should continue its practice of considering Regulatory Asset status for costs that are (1) of an extraordinary nature; (2) are non-recurring; (3) material in terms of dollar value; (4) and not directly related to current annual utility services.

Union confirmed in its responses to PSC-2 and PSC-6 that the MISO related costs the Company wishes to defer in a Regulatory Asset account are not of an extraordinary basis, are recurring on an annual basis, are non-material, and are related to services that are currently provided (rather than services to be provided in some future period). The response to PSC-6 indicates that the estimated MISO costs in 2005 of \$1.54 million which the Company wishes to defer represents only 0.91% of the Company's total 2005 electric operation and maintenance

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*Heat and Power Company from November 1, 1998 to October 31, 2000 and In the Matter of the Application of the Union Light, Heat and Power Company for Authority to Provide a Reduction in Rates to Customers Through the Fuel Adjustment Clause.*

expenses of \$168.6 million. This cannot be considered to be a “material” cost impact. In this same response to PSC-6, the Company also confirms that the 2005 MISO cost of \$1.54 million is directly related to the transmission services to be received in 2005.

In apparent conformity with the settlement agreement entered into in Case Number 2001-00058, Union has already has been expensing (rather than deferring) approximately \$2.65 million worth of MISO costs from December 15, 2001 through March 31, 2005. The response to AG-4 confirms that from December 15, 2001 through March 31, 2005, the Company incurred of \$2,344,129 for MISO Schedule 10 costs and \$303,200 for MISO Schedule 10-FERC costs. In its response to AG-5, the Company confirmed that,

The Company expensed the MISO Schedule 10 and Schedule 10-FERC charges from December 15, 2001 through March 31, 2005. The costs are no longer on the Company’s books and we are not requesting deferral treatment of these costs...

Under the circumstances and considering the settlement agreement, there is no reason to allow Union to defer similar recurring annual MISO costs that are also related to current transmission services and that are less “material” than the prior expensed costs of \$2.7 million.

Even if the relief sought did not run directly contrary to the settlement agreement of Case Number 2001-00058, the Company’s proposal to defer these costs until future rate treatment in the 2007 rate case represents inappropriate single issue ratemaking. It is inappropriate to single out this one isolated “in-between-rate-case” cost increase item for special deferral and eventual rate treatment without considering all other items that make up the ratemaking formula. One cannot look at this cost increase item in a vacuum. Rather, one should consider this cost increase within the overall universe of the ratemaking formula in the context of a test period. For example, in recent years, the Company’s cost of capital has experienced a significant decrease from the cost of capital that is built into the Company’s current rates. As confirmed in the

responses to AG-10 and AG-11, the Company's current cost of long term debt has decreased to a level of 6.308% as compared to the cost of long term debt of 9.375% that is built into the current rates. Similarly, the Company's current cost of short term debt has decreased to a level of 3.495% as compared to the cost of short term debt of 5.935% that is built into the current rates. With regard to the Company's overall cost of capital, the response to AG-10 shows that the overall cost of capital currently built into the rates of ULH&P is 10.11%. By comparison, the Company's currently claimed overall cost of capital for 2005 -- as claimed in the current ULH&P rate case Schedule J-1, page 1 -- is 8.768%.<sup>2</sup> When this overall cost of capital reduction is applied to the Company's jurisdictional electric rate base for 2005 of \$472,304,992 (see WPA-1b in the current ULH&P rate case), it has the effect of reducing the Company's annual recurring revenue requirement by approximately \$3.8 million.<sup>3</sup> Thus, this annual revenue requirement reduction is much more "material" than the Company's proposed annual MISO cost deferral, but is not recognized in the Company's single issue deferred debit proposal. This reduction in overall expense is even greater since the Kentucky state income tax rate was reduced from 8.25% to 7.00% and will be further reduced to 6.00% in 2007. The Company has stated in its response to AG-14 that it has not quantified the impact of this very significant cost reduction. However, one can be sure that it will result in a significant reduction in the Company's annual recurring revenue requirement, a reduction item that is not recognized in the Company's single-issue deferred debit proposal.

In the third paragraph of its response to PSC-3, the Company states that its MISO deferral proposal should be accepted because it is caused by changes resulting from unanticipated conditions, the magnitude of which was unforeseeable when the current base rates for the

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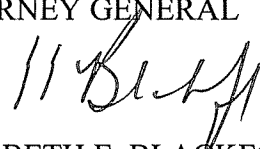
<sup>2</sup> This claimed cost of capital of 8.768% includes a ULH&P-claimed return on equity rate of 11.20%.

<sup>3</sup> Calculation: The 10.11%, grossed up for income taxes, is 13.673%. The 8.768%, grossed up for income taxes, is 12.871%. Difference between 13.673% and 12.871% is .0802% x rate base of \$472.3 million = \$3.8 million.

Company were set. This is no different than the change in the Company's cost of capital and the reduction in the Company's income tax rate that resulted from unanticipated conditions, the magnitude of which were also unforeseeable when the rates were set and the settlement agreement was entered into. Simply put, there is no basis to grant the requested relief. Therefore, it should be denied.

Respectfully submitted

GREGORY D. STUMBO  
ATTORNEY GENERAL

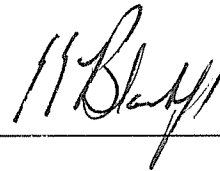
A handwritten signature in black ink, appearing to read "E. Blackford", is written over the typed name of Elizabeth E. Blackford.

ELIZABETH E. BLACKFORD  
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NOTICE OF FILING AND CERTIFICATION OF SERVICE

I hereby give notice that I have filed the original and ten true copies of the foregoing with the Executive Director of the Kentucky Public Service Commission at 211 Sower Boulevard, Frankfort, Kentucky, 40601 this the 31<sup>st</sup> day of May, 2005, and certify that this same day I have served the parties by mailing a true copy, postage prepaid, to the following:

JOHN J FINNIGAN JR ESQ  
SENIOR COUNSEL  
THE UNION LIGHT HEAT AND POWER COMPANY  
139 EAST FOURTH STREET  
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