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July 28, 2005

Honorable John J. Finnigan, Jr.
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The Union Light, Heat and Power Company
139 East Fourth Street
Cincinnati, OH 45202

CERTIFICATE OF SERVICE

RE: Case No. 2005-00096
The Union Light, Heat and Power Company

I, Beth O'Donnell, Executive Director of the Public Service Commission, hereby certify that the enclosed attested copy of the Commission's Order in the above case was served upon the addressee by U.S. Mail on July 28, 2005.

A handwritten signature in black ink, appearing to read "Beth O'Donnell", written over a horizontal line.

Executive Director

BOD/jc
Enclosure

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COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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

O R D E R

On March 3, 2005, The Union Light, Heat and Power Company ("ULH&P") filed its application for approval to establish regulatory assets and liabilities for certain Midwest Independent Transmission System Operator, Inc. ("MISO") related incurred costs and received revenues. ULH&P has identified the MISO-related costs and revenues it is seeking to defer as those related to wholesale transmission service under MISO Schedules 10,¹ 10-FERC,² 16,³ 17,⁴ and MISO's Open Access Transmission and

¹ Schedule 10 allows MISO to recover all costs associated with operating MISO except for those costs recovered pursuant to MISO Schedules 1, 16, and 17. Schedule 10 was effective December 15, 2001.

² Schedule 10-FERC allows MISO to recover from transmission customers the Federal Energy Regulatory Commission's ("FERC") Assessment Fee invoiced to MISO. Schedule 10-FERC was effective September 1, 2003.

³ Schedule 16 allows MISO to recover costs for administering Financial Transmission Rights ("FTR") among the stakeholders in the transmission system who hold FTRs. Schedule 16 was effective April 1, 2005.

⁴ Schedule 17 allows MISO to recover costs for managing the day-ahead and real-time energy markets that will be created under MISO's TEMT. Schedule 17 was effective April 1, 2005.

Energy Markets Tariff ("TEMT").⁵ ULH&P is requesting that it be allowed to defer these costs and revenues on a going-forward basis effective April 1, 2005.⁶ ULH&P estimated the new MISO-related costs to be \$1.58 million for 2005 and \$1.79 million for 2006.⁷

ULH&P stated that as a transmission customer of MISO, it incurs incremental MISO charges related to wholesale transmission service for its retail customers.⁸ ULH&P argued that the new MISO services have allowed it to improve service for its retail customers in the form of enhancing reliability, through the improved management of transmission congestion and real-time balancing of generating units.⁹ ULH&P noted that the new MISO services have resulted in it incurring significant new costs that are not currently reflected in its retail electric rates. ULH&P acknowledged that it entered into a settlement in Case No. 2001-00058,¹⁰ which froze its retail electric rates through December 31, 2003 and limited it from certain rate increases through December 31, 2006. However, ULH&P argued that:

⁵ The TEMT contains the terms and conditions under which MISO will administer the real-time and day-ahead energy markets, using the principles of locational marginal pricing and FTRs. ULH&P will incur numerous new costs and receive new revenues under the TEMT, which are listed in the Application at 5.

⁶ Response to the Office of the Attorney General's ("AG") First Data Request dated April 12, 2005, Item 3.

⁷ Response to the Commission Staff's First Data Request dated April 12, 2005, Item 5. The estimated costs reflect only the charges under MISO Schedules 10, 10-FERC, 16, and 17. Costs associated with the MISO TEMT were not included in the estimates.

⁸ Application at 3.

⁹ ULH&P Comments filed May 31, 2005 at 3.

¹⁰ Case No. 2001-00058, The Application of The Union Light, Heat and Power Company for Certain Findings under 15 U.S.C. § 79Z.

This settlement should not preclude ULH&P from obtaining cost recovery of these costs, however, because these costs are for new MISO services which could not have been contemplated by the parties at the time of the settlement in Case No. 2001-00058. Further, no recovery of such costs will take place until after December 31, 2006.¹¹

ULH&P further argued that the new MISO costs were material, the proposed accounting deferrals were appropriate based on the matching principle, and that the deferrals would produce long-term benefits for customers.¹²

The AG requested and was granted intervention in this proceeding. The parties agreed that this case should be decided on the basis of the record, including filed comments, without an evidentiary hearing.

In his comments, the AG argued that ULH&P's request to establish regulatory assets and liabilities for MISO-related costs and revenues not already included in retail electric rates should be denied. The AG contended that the MISO-related costs identified by ULH&P are related to transmission services currently being provided to ULH&P, are a recurring expense for ULH&P, are not extraordinary in nature, and do not reflect a material cost increase to ULH&P. The AG expressed serious concerns about the effects the proposed deferrals would have relative to the settlement in Case No. 2001-00058. The AG argued:

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 would be offset by imputed revenues, and when, as appears to be

¹¹ ULH&P Comments filed May 31, 2005 at 3.

¹² Id. at 4.

the case here, a rate increase to recover the costs before December 31, 2006, would not otherwise be sought.¹³

The AG stated that absent the settlement agreement, the new MISO-related costs did not warrant deferral, and urged the Commission to continue its past practice of considering regulatory asset status for costs that are of an extraordinary nature; are non-recurring; are material in terms of dollar value; and are not directly related to current annual utility services.

Based on the evidence of record and being otherwise sufficiently advised, the Commission finds that ULH&P's new MISO-related costs are not material. While ULH&P has determined that the projected MISO transmission expenses for 2005 reflect 8.46 percent¹⁴ of the projected total transmission expense for 2005, the MISO transmission expenses for 2005 reflect approximately 0.91 percent¹⁵ of the total electric operation and maintenance expenses for ULH&P in 2005. The determination that an expense is material is based on the relative size of the particular expense to the total expenses of the utility, not a specific category of expense. Consequently, the new

¹³ AG Comments filed May 31, 2005 at 2.

¹⁴ Response to the Commission Staff's Second Data Request dated May 10, 2005, Item 1.

¹⁵ Response to the Commission Staff's First Data Request dated April 12, 2005, Item 6(b).

MISO-related expenses quantified by ULH&P are less than 1.0 percent of its total annual expenses and do not qualify as being material.¹⁶

The Commission also finds that ULH&P's proposed accounting deferrals are not appropriate based on the matching principle. ULH&P has failed to explain how deferring the costs for transmission service actually received in 2005 results in a proper match of those costs with the 2005 transmission service that gave rise to those costs. ULH&P has argued that, "No mechanism currently allows ULH&P to recover these MISO costs from retail customers; therefore, current matching of cost recovery with the transmission service provided is impossible."¹⁷ However, this statement ignores the fact that there is no mechanism to allow recovery of MISO costs because the settlement agreement in Case No. 2001-00058 expressly prohibits ULH&P from recovering those wholesale transmission costs.

The Commission further finds that the accounting deferrals would not produce long-term benefits for customers. When asked if the future benefits of creating the proposed regulatory assets and liabilities for the MISO costs were available only to ULH&P's shareholders, ULH&P responded:

Over the long run, both shareholders and customers benefit from a Commission policy which allows utility companies to create accounting deferrals to recover the costs of providing new services to customers because this would incentivize [sic] utility companies to provide necessary

¹⁶ ULH&P claimed that there were additional MISO-related costs associated with the MISO "Day 2 Market." However, when asked to quantify these costs, ULH&P stated that it could not estimate these costs for 2005. See Response to the Commission Staff's First Data Request dated April 12, 2005, Item 6(a) and Response to the AG's First Data Request dated April 25, 2005, Item 6.

¹⁷ Response to the Commission Staff's Second Data Request dated May 10, 2005, Item 7.

or innovative services and could reduce the frequency of costly, time consuming rate proceedings.¹⁸

As ULH&P has previously stated, the new MISO-related costs are being incurred to provide current transmission services. While MISO may be a new provider of wholesale transmission service, ULH&P has historically received such service under tariffs of its parent, The Cincinnati Gas and Electric Company. Thus, ULH&P's customers are not being provided with a new service. ULH&P has not explained why it requires incentives to secure this necessary service. Consequently, ULH&P has not identified any long-term benefits for its customers resulting from the deferral of the MISO-related costs. Instead, it has clearly shown a desire to specifically recover these costs from future ratepayers long after the necessary transmission service has been provided to current ratepayers.

Lastly, the Commission finds no merit to ULH&P's argument that since the new MISO-related costs could not have been contemplated by the parties at the time of the settlement in Case No. 2001-00058, it is reasonable to allow for the establishment of the proposed regulatory asset and liability accounts. The contention that no party could have anticipated the new MISO-related costs is not persuasive. As the Commission found in the June 1, 2001 Order in Case No. 2001-00058:

[T]he Settlement Agreement provides that ULH&P's base rates and FAC will be frozen through at least December 31, 2003. ULH&P may file an application to adjust its base rates effective January 1, 2004 to recover increases in costs related to its retail T&D service, but not for costs related to its purchase of wholesale transmission or generation service.¹⁹ (emphasis added)

¹⁸ Response to the Commission Staff's Second Data Request dated May 10, 2005, Item 6.

¹⁹ Case No. 2001-00058, June 1, 2001 Order at 2-3.

Thus, as part of that Settlement Agreement, ULH&P voluntarily gave up its right to recover increases in its wholesale transmission costs. The Commission also stated in the June 1, 2001 Order that if ULH&P decided to file an application to adjust base rates due to increases in retail transmission and distribution (“T&D”) costs, ULH&P would be required to reflect the imputation of \$8.0 million in revenue to offset its T&D costs.²⁰

After consideration of the evidence in this record, the Commission finds that ULH&P’s proposal to establish regulatory asset and liability accounts for the new MISO-related costs and revenues should be denied. The Commission is not persuaded by the arguments put forth by ULH&P. We share the concerns expressed by the AG that the approval of the proposed deferrals will in effect remove a benefit included in the settlement agreement in Case No. 2001-00058. Further, the record shows that the new MISO-related costs and revenues are normal, recurring business transactions and that the quantified increase is not material to ULH&P’s total electric operation and maintenance expenses. Finally, ULH&P has failed to identify the benefits that will be available to future ratepayers and shareholders if these costs and revenues are deferred.²¹

²⁰ Id. at 3.

²¹ The Commission, in previous decisions establishing regulatory asset and liability accounts, has considered the non-recurring nature of the costs, the material nature of the costs, the future benefits of the costs available to ratepayers and shareholders, and the matching of those benefits with the costs. See Case No. 1990-00158, Adjustment of Gas and Electric Rates of Louisville Gas and Electric Company, rehearing Order dated September 30, 1991 at 14.

IT IS THEREFORE ORDERED that ULH&P's request to establish regulatory assets and liabilities related to new MISO-related wholesale transmission costs and revenues is denied.

Done at Frankfort, Kentucky, this 28th day of July, 2005.

By the Commission

ATTEST:



Executive Director