COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN ADJUSTMENT OF GAS AND ELECTRIC RATES OF THE UNION LIGHT, HEAT AND POWER COMPANY	) CASE NO. 90-041

O R D E R

On October 2, 1990, the Commission issued its Order authorizing The Union Light, Heat and Power Company ("ULH&P") an increase in gas and electric rates. On November 12, 1990, the Commission granted rehearing on the following issues: rental expense; propane inventory; Rate OL-Outdoor Lighting Service; standby service; and Energy Assurance Program. That Order also established a schedule for the filing of prepared direct and response testimony. The Commission subsequently joined the issue of gas safety inspection charges.[1] This issue was originally investigated in this case and addressed by the Commission's October 2, 1990 Order.

The Commission also established a schedule permitting discovery on the rehearing issues and held a hearing on April 17, 1991 at the Commission's offices in Frankfort, Kentucky.

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1 Case No. 90-334, The Union Light, Heat and Power Company's Tariff Charges for Inspection and Testing of Customers' Gas House Piping and Service Installations, Order dated December 10, 1990.

Rehearing briefs were filed by ULH&P, Attorney General's office, Utility and Rate Intervention Division ("AG"), and Office of Kentucky Legal Services Program on behalf of Brenda Freeman ("KLS"). The Commission's findings on each of the rehearing issues are set forth below.

Rental Expenses

The AG requested and was granted rehearing on test year rental expenses. ULH&P was instructed to file testimony detailing its rental expense transactions with its parent corporation, Cincinnati Gas & Electric Company ("CG&E"), and to provide specific descriptions of charges included in a select group of accounts. All ULH&P's rental expenses are allocations of expenses incurred by CG&E.

ULH&P provided a detailed explanation of its cost allocation methodologies concerning the rental expenses of offices and equipment jointly used by CG&E and ULH&P. ULH&P also provided the requested descriptions for charges to specific accounts. In its rehearing brief, ULH&P noted that its cost allocation methodologies are subject to review by internal and external auditors and that the methodologies have always been found to be adequate and constituted a proper approach to allocating the rental expenses.

The AG did not file any rehearing testimony. However, at the April 19, 1991 rehearing, and again in its rehearing brief, the AG claimed that ULH&P's rental expense was excessive and that this expense be evaluated on the basis of what the cost would be if ULH&P was a stand-alone utility, rather than a subsidiary of CG&E.

While the theory underlying the AG's proposed methodology is proper for consideration, the AG has failed to present any evidence to demonstrate that ULH&P's test year rental expense is unreasonable or what a reasonable level of rental expense is for a stand-alone utility. Rather than providing an expense level for a stand-alone surrogate, the AG merely proposed using ULH&P's 1988 expense level with a five percent increase.

The Commission finds that ULH&P has adequately explained the allocation of rental expenses from CG&E. Although ULH&P did experience a significant increase in rental expenses during the test year, most of the increase is attributable to higher levels of expenses incurred by CG&E, not higher allocations. There is no evidence to show that the test year rental expenses are unreasonable. Therefore, the Commission will affirm its original decision on this issue.

Propane Inventory

In the October 2, 1990 Order, the Commission removed $1,583,150 from ULH&P's rate base attributable to CG&E's share of the 13-month average propane inventory. The adjustment was based on the finding that only ULH&P's share of the propane inventory should be included in rate base. ULH&P requested rehearing on the basis that it is erroneous to not exclude the income it receives from CG&E for its portion of the propane inventory. The AG requested rehearing because he believed that the propane inventory maintained by ULH&P was excessive. However, the AG neither filed rehearing testimony on this issue nor addressed the merits of the adjustment in his rehearing brief.

In its rehearing testimony, ULH&P explained that CG&E pays a monthly charge which includes depreciation expense, maintenance expenses, insurance, taxes, land rentals, and a return on the net plant investment and average propane inventory. CG&E is also allocated a share of the operation expenses related to the propane operations. The monthly charge determination, the allocation of operation expenses, and the assignment of the propane inventory are covered by a written memorandum between CG&E and ULH&P. The rate of return paid by CG&E is established as the rate of return on rate base granted by the Commission in ULH&P's most recent rate case. In the test year, the monthly charge provided $435,778 in annual revenue to ULH&P.

ULH&P provided evidence that, during the test year, the assignment of the propane inventory was changed due to improvements made to the Erlanger, Kentucky facility by ULH&P. Prior to the change, CG&E was assigned 80 percent of the propane inventory and the monthly charge and expense allocation reflected the 80 percent assignment. The change in the assignment reduced CG&E's share to 64 percent and increased ULH&P's share accordingly. The monthly charge revenues from CG&E and expense allocation recorded in the test year reflected a blend of the 80 and 64 percent assignment.

ULH&P stated that it used its propane inventory for supplying daily peak shaving demands, needle peaking to maintain system pressures, base loading, and conducting a vaporization program for its customers. ULH&P has planned for 22,000 Mcf of its design day requirements to be supplied by propane, and has accordingly reduced the amounts of natural gas under contract from its pipeline suppliers. ULH&P stated that its recent historic usage of propane has been low because of favorable weather conditions and the availability of natural gas on the spot market from pipeline suppliers at a cost lower than propane.

In its rehearing petition, ULH&P suggested that the Commission either remove the test year revenues earned from CG&E or restore the CG&E share of the propane inventory to rate base. The Commission finds that since ULH&P does receive revenues for CG&E's share of the propane stored at the Erlanger, Kentucky facility, and those revenues were included as an offset to revenue requirements, it is appropriate to restore the CG&E share of the propane inventory to the rate base of ULH&P.

The Commission notes that ULH&P has not performed any studies to determine its optimal propane inventory level. Although ULH&P's historic usage data and peak demand day information do not by themselves totally support the test year level of propane inventory, recognition must be given to ULH&P's increased reliance on propane inventory during the test year. This increased reliance on propane inventory was demonstrated by changes in ULH&P's contracts with pipeline suppliers. The Commission finds no basis to adjust ULH&P's test year propane inventory level. However, ULH&P should undertake a comprehensive study to determine its optimal propane inventory level. This study should include an analysis that includes, but is not limited to, historic usage, utilization for peak day needs, capacity requirement studies, and econometric modeling.

ULH&P did not propose any adjustments to the revenues or operating expenses related to the propane inventory or the operation of the propane facilities even though the test year included a change in the assignment percentages of the inventory. Changes also had occurred with respect to Kentucky corporate income tax rates, PSC assessment rates, and the rate of return on rate base used to determine the revenues to be received from CG&E. The Commission believes it is appropriate to recalculate the revenues and allocated expenses to reflect the changes in assignment percentages, taxes, and return. Based on information of record, the Commission has determined that these adjustments will result in a net increase in revenue requirements of $82,843,[2] which will only affect the gas customers of ULH&P.

Outdoor Lighting Service

ULH&P proposed to increase the monthly rate for the 50,000 lumens floodlight fixture on its Outdoor Lighting ("OL") Tariff to correct an error in the original calculation of its proposed rate. The original calculation, part of ULH&P's conversion from a cents-per-KWH charge to a dollars-per-fixture charge for its street and outdoor lighting rates, produced an existing equivalent rate of $4.26 per fixture per month and a proposed rate of $4.51 per fixture per month. These rates were in error because the number of 50,000 lumens floodlighting fixtures included in ULH&P's

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2 As shown in Appendix B, attached hereto and incorporated herein by reference.

calculation was overstated at 151, compared to the correct number of 78. This overstatement caused the Commission-approved rate of $4.44 to also be in error.

On rehearing, ULH&P restated the existing equivalent rate at $8.26 based on the correct number of fixtures of 78. ULH&P then proposed to increase that rate by 4.23 percent, the same percentage increase authorized by the Commission's October 2, 1990 Order when increasing the original filed rate from $4.26 to $4.44. This calculation produces an increased rate of $8.61.

Applying the same percentage increase to the higher equivalent rate, as proposed by ULH&P, would result in slightly greater revenues than produced by the October 2, 1990 Order which granted a rate increase from $4.26 to $4.44. The original rate of $4.44 was designed to produce revenues of $8,038 from the 50,000 lumens floodlight based on 151 fixtures. The proper correction of that rate results in a rate that produces the same revenues based on 78 fixtures. Hence, the corrected rate for the 50,000 lumens floodlighting fixture on ULH&P's OL Tariff is $8.59 per fixture per month.

Standby Service

In our Order of October 2, 1990, a tariff was approved making standby service available to all gas customers at a rate based on ULH&P's system-average pipeline demand cost. On rehearing, ULH&P maintains that separate rates should be established for firm and interruptible standby service and that each rate should include a component for a Gas Inventory Charge ("GIC").

ULH&P proposed: 1) a rate of $1.20 per Mcf for firm standby service based on Columbia Gas Transmission Corporation's ("TCO") D-1 contract demand rate; 2) requiring that customers contract for firm standby service to reflect a 25 percent load factor; and 3) a GIC based on taking 75 percent of contract levels. For interruptible standby, ULH&P proposed to increase the Commission-approved rate of 63.31 cents per Mcf to 89.6 cents to reflect the same GIC as proposed for firm standby service.

The Commission is persuaded that ULH&P's tariff should be modified to reflect both firm and interruptible standby service and the differing rates for those two services. ULH&P's proposal for determining the rate for firm standby reflects the costs incurred to stand ready to provide firm service and, therefore, should be approved.

We are not persuaded that the rate for interruptible standby service should be modified to include a GIC. As we stated in our October 2, 1990 Order, interruptible standby service can be offered and provided without contracting for additional supplies. The interruptibility of this service is dependent upon ULH&P's system needs and, in that regard, is similar to interruptible sales service. A customer who signs up for interruptible standby service will neither pay for, nor be entitled to receive, any specific volumes because ULH&P has not contracted for any supply on behalf of such a customer. Rather, the customer will merely pay to have access to any volumes that may be available from ULH&P on the day the customer loses its own supply.

Both the firm and interruptible standby provisions are set out in the attached Appendix A. The rates reflect ULH&P's current pipeline demand charges per its latest gas cost adjustment filing.[3] The rate for firm service reflects TCO's current D-1 Demand Rate at an equivalent of 1,030 BTU per cubic feet. The interruptible rate reflects the total demand costs and total annual throughput included in the current gas cost adjustment.

The Commission reminds ULH&P that these standby charges are to be revised with each quarterly gas cost adjustment. The tariff approved in our Order of October 2, 1990 includes such a provision for interruptible standby and ULH&P also agreed that such adjustment would be appropriate for the firm standby rate.[4] We mention this because ULH&P has failed to revise its approved rate for interruptible standby in the three gas cost adjustments filed since last October.

Safety Inspection Charges

ULH&P has proposed charges for safety inspection of customers' house piping and service installations. The issue originated in this proceeding on the question of whether ULH&P should record the revenues and expenses associated with these inspections below the line as non-utility operations. In the

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3 Case No. 90-041-C, Purchased Gas Adjustment Filing of The Union Light, Heat and Power Company, Order dated May 30, 1991.

4 ULH&P's Response to Commission Rehearing Data Request, Item 15(d).

October 2, 1990 Order, the Commission found these inspections to be utility operations which should be recorded above the line and that ULH&P would need Commission approval of any inspection charges.

ULH&P filed proposed tariff charges for safety inspection and its supporting cost data based on the inspections performed during the test year and the first six months of calendar year 1990. The issues, as developed in this rehearing, are: (1) should these costs be charged to the specific customers for whom the inspections are performed or should they be recovered from the general customer population through ULH&P's rates for gas service; and (2) if charges to specific customers are appropriate, are ULH&P's proposed charges supported by its cost data.

ULH&P argues that the costs of safety inspections should be charged to the cost causer, i.e. the customer for whom the inspection is performed. The AG contends that since the inspections are safety-related and non-discretionary, the costs should be spread over all customers and recovered through ULH&P's rates.

ULH&P is required to perform these inspections pursuant to Commission regulations. Being safety-related, these inspections benefit all customers and the general public, not just the customer for whom the inspection is being performed. The customer has no discretion either to decline the inspection or to have the inspection performed by someone other than ULH&P. Given these conditions, the Commission finds that the cost of these inspections should be recovered through rates rather than being charged directly to the customer for whom the inspection was performed. Therefore, ULH&P's rates will be increased to recover the cost of $103,461 incurred for inspections during the test year. This decision results in increases of $.0094 to the commodity rates in ULH&P's residential and general service rate schedules.[5] This produces no change in ULH&P's revenue requirement but merely shifts the cost recovery from one form of revenue - inspection charges - to another form of revenue - gas rates.

Energy Assurance Plan

On rehearing, KLS proposed that an energy assurance plan ("EAP") be instituted for ULH&P on a pilot, or test, basis. The EAP would apply to low-income customers eligible for Low Income Home Energy Assistance Program ("LIHEAP") benefits. These customers would make fixed payments equal to 6 percent of their income for heating bills and 3 percent for non-heating bills. These customers would also make payments of $3 per month for 36 months to retire any prior arrearages, with any arrearages in excess of the $108 produced by these payments to be forgiven and written off by ULH&P.

ULH&P argued against implementation of an EAP on several points: (1) the plan results in discriminatory treatment of certain members of the low-income customer class; (2) it violates

5 ULH&P's Response to Hearing Data Requests, Item No. 3, filed May 6, 1991.

KRS 278.170 which prohibits rates that provide an unreasonable benefit or advantage to any person; (3) KLS has not supported its contention that implementation of an EAP would increase net revenues collected from the EAP subclass; and (4) implementation of the EAP would create for ULH&P a substantial administrative burden and expense which would have to be absorbed by other ratepayers. ULH&P indicated that the experience of CG&E with the Ohio PIP Plan demonstrates that the EAP will cost significantly more than KLS's estimate.

The Commission has given serious consideration to this issue. As stated in our Order granting rehearing, the Commission recognizes the impact that high utility bills can have on low-income customers and that the EAP appears to address this problem. However, the Commission is not persuaded that the EAP, or any utility-sponsored program, is the definitive answer to the problem. While KLS posits that an EAP will carry little administrative costs, ULH&P maintains such a program would create significant administrative costs that would have to be absorbed by other customers. If ULH&P is correct, the EAP, contrary to KLS's contentions, will not result in the stated objective of providing service at the least cost to all ratepayers. Clearly, if this objective is not assured of being met, the EAP, on a pilot basis or permanent basis, is merely a rate subsidy program beset with the discrimination and statutory problems outlined in our October 2, 1990 rate Order. For these reasons, the Commission finds that a pilot EAP should not be implemented for ULH&P.

Revenue Requirements

The total additional revenues have been recomputed to reflect both the Commission's October 2, 1990 Order and the propane revenue and expense adjustment explained herein. A breakdown between electric and gas operations of the revised total operating income and the increase in total revenue allowed is as follows:

	Electric	Gas	Total
Net Operating Income Found Reasonable	$8,909,720	$6,909,423	$15,819,143
Adjusted Net Operating Income	5,045,956	3,385,269	8,431,225
Net Operating Income Deficiency	3,863,764	3,524,154	7,387,918
Gross Up Revenue Factor for Taxes	1.66878	1.66878	1.66878
Additional Revenue Required	6,447,779	5,881,043	12,328,822

The revenues granted will provide a rate of return on the net original cost rate base of 11.05 percent and an overall return on total capitalization of 11.25 percent. Gross operating revenues, based on the adjusted test year and the corrected income tax expense allowed herein, are $197,754,236. These operating revenues include $138,501,346 in electric revenues and $59,252,890 in gas revenues.

The gross operating revenues are determined as follows:

	Electric	Gas	Total
Gross Operating Revenues, per the October 2, 1990 Order	$138,501,346	$59,226,419	$197,727,765
Adjustment to Operating Revenues, CG&E Propane Revenues, see Appendix B	0	(56,372)	(56,372)
Adjusted Gross Operating Revenues	138,501,346	59,170,047	197,671,393
Additional Revenues Granted Herein	0	82,843	82,843
Gross Operating Revenues from Rates and Charges in Appendix A	138,501,346	59,252,890	197,754,236

IT IS THEREFORE ORDERED that:

1. The rates set forth in Appendix A be and they hereby are approved for service rendered by ULH&P on and after July 19, 1991.

2. Within 30 days of the date of this Order, ULH&P shall file its revised tariff sheets reflecting the rates approved herein.

Done at Frankfort, Kentucky, this 19th day of July, 1991.

PUBLIC SERVICE COMMISSION

Chairman

Robert M. Davis
Vice Chairman

Commissioner

ATTEST:

Lee M MacCracken
Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 90-041 DATED 7/19/91

The following rates and charges are prescribed for the customers in the area served by The Union Light, Heat and Power Company. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order. The gas rates included herein reflect all gas cost adjustments through Case No. 90-041-C.

GAS SERVICE RATES

RATE RS
RESIDENTIAL SERVICE

	Base Rate		Gas Cost Adjustment		Total Rate
Commodity Charge For All CCF Consumed	18.63¢	Plus	28.08¢	Equals	46.71¢ Per CCF

RATE GS
GENERAL SERVICE

	Base Rate		Gas Cost Adjustment		Total Rate
Commodity Charge For All CCF Consumed	16.69¢	Plus	28.08¢	Equals	44.77¢ Per CCF

RATE SS
STANDBY SERVICE

APPLICABILITY

Available to any transportation customer requiring standby service where Company has adequate peak day and/or annual contractual arrangements. If contractual arrangements are inadequate to accommodate customer, Company shall decline to initiate such service until adequate arrangements can be completed.

FIRM STANDBY SERVICE - NET MONTHLY BILL

The net monthly bill is determined as follows. For the volume specified in the written agreement, the customer shall pay an additional charge of 11.84 cents per CCF. This reflects the D-1 demand rate of Columbia Gas Transmission Corporation calculated at a 25 percent load factor with an equivalent BTU value of 1030, plus a gas inventory charge based on taking 75 percent of contract levels. This charge is subject to change with the Company's quarterly GCA filing. This amount is due and payable, except at such time as the standby volumes are required by the customer. In that instance, customer shall be billed for standby volumes at the General Service sales rate.

INTERRUPTIBLE STANDBY SERVICE - NET MONTHLY BILL

The net monthly bill is determined as follows. For the volume specified in the written agreement, the customer shall pay an additional charge of 7.73 cents per CCF which is the Company's average pipeline demand cost based on total annual throughput as reported in the most recent GCA. This charge is subject to change with the Company's quarterly GCA filing. This amount is due and payable, except at such time as the standby volumes are required by the customer. In that instance, customer shall be billed for standby volumes at the Company's current gas cost recovery charge plus the transportation rate from Rate IT.

LATE PAYMENT CHARGE

Payment of the total amount due must be received in the Company's office by the due date shown on the bill. When not so paid, an additional amount equal to five percent (5%) of the unpaid balance is due and payable.

TERMS AND CONDITIONS

The customer shall enter into a written agreement with the Company. Such agreement shall set forth specific arrangements concerning the volumes to be reserved for customer and any other circumstances relating to the individual customer's standby needs.

The primary term of the contract shall be a minimum of one (1) year with a renewal or termination date of October 31 of each year. After completion of the primary term, such contract shall continue unless cancelled by either party upon thirty (30) days written notice preceding October 31 of each year.

SERVICE REGULATIONS

The supplying of, and billing for, service and all conditions applying thereto are subject to the jurisdiction of the Kentucky Public Service Commission and to the Company's rules and regulations currently in effect, as filed with the Kentucky Public Service Commission, as provided by law.

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 90-041 DATED 7/19/91

Determination of Revenue Received From CG&E for the Erlanger Plant

	TOTAL FIXED CHARGES[1]	CG&E SHARE @ 64.00%
Property Plant & Equip. as of 11/30/89	$3,406,752	$2,180,321
Less: Accum. Deprec. as of 11/30/89	3,114,311	1,993,159
Net Plant Investment	292,441	187,162
Add: 12 Month Aver. Propane Invent. 11/30/89	2,497,051	1,598,113
Net Plant Investment & Aver. Propane Invent.	2,789,492	1,785,275
Return on Net Plant & Inventory @11.17%	311,586	199,415
Annual Depreciation	122,651	78,497
Property Taxes	40,811	26,119
Insurance	2,663	1,704
Land Rental	0	0
Federal and State Income Tax	114,388	73,208
Subtotal	592,100	378,944
PSC Assessment @ .1221	723	463
Total Cost (Revenue Due from CG&E)	592,822	379,406
Calculation of Federal and State Income Tax -		
Net Plant Investment & Aver. Propane Invent.	2,789,492	
Return on Net Plant & Inventory @ 11.17%	311,586	
Cost of Debt -		
Capital Structure 50.1%	1,397,535	
Cost of Debt 9.73% (Blended)	135,980	
Cost of Equity (Return - cost of debt)	175,606	
Required Before Taxes (Cost of Equity/.60555)	289,994	
Taxes at Blended 39.445%	114,388	
Change in Revenues from CG&E:		
Test Year Actual Revenues		435,778
Calculated Revenues		379,406
Decrease in Revenues		(56,372)

1 Rehearing Exhibit DEB-1 adjusted to correct return on net plant and state tax rate.

Adjustment to ULH&P Expenses Relating to Change in Allocation Percentage

COMPONENT OF COST	TOTAL[2]	ULH&P @ 36.00%
ACCT. 711 - Steam Expenses	$ 19,948	$ 7,181
ACCT. 712 - Other Power Expenses	14,558	5,241
ACCT. 717 - Liquidified Propane Gas Expenses	30,355	10,928
ACCT. 728 - LPG	308,912	111,208
ACCT. 735 - Miscellaneous Production Expense	81,990	29,516
ACCT. 875-2 - Measuring and Regulating	7,538	2,714
Total	463,301	166,788
ULH&P Test Year Actual		141,180
Increase in ULH&P's Expenses		25,608

Determination of State and Federal Income Tax Effect:

Reduction in ULH&P's Revenues	(56,372)
Increase in ULH&P's Expenses	25,608
Net Effect on Taxable Income	(81,980)
Reduction in State Income Taxes [-$81,980 x 8.25%]	(6,763)
Reduction in Federal Income Taxes [(-$81,980 - (-$6,763)) x 34%]	(25,574)

Determination of Increase in Revenue Requirements:

Effect on Net Operating Income of ULH&P -

Change in Operating Revenues		(56,372)
Change in Operating Expenses		
Expense Allocation	25,608	
State Income Taxes	(6,763)	
Federal Income Taxes	(25,574)	(6,729)
Total Effect on Net Operating Income		(49,643)

Reduction in Net Operating Income Results in an Increase in Revenue Requirements, as Follows -

Total Effect on Net Operating Income	49,643
Gross Up Revenue Conversion Factor	1.66878%
Increase in Revenue Requirements	82,843

2 Total Expenses From Response to Item 7 of March 18, 1991 Order.