

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION OF THE NEED)	
FOR AFFILIATE TRANSACTION RULES)	ADMINISTRATIVE
AND COST ALLOCATION REQUIREMENTS)	CASE NO. 369
FOR ALL JURISDICTIONAL UTILITIES)	

O R D E R

During the period December 1996 through March 1997, Commission Staff had a series of informal discussions with two groups representing plumbing, heating and cooling contractors and several utilities, regarding issues related to the competitive lines of business being conducted by utilities and their non-regulated subsidiaries or affiliates. On March 18, 1997, the Commission received a letter from the Lexington Contractors Coalition For Fair Competition urging the Commission to undertake a study of the entry into competitive lines of business by unregulated subsidiaries or affiliates of regulated utilities. In a recent case involving the merger of the holding companies of Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU")¹ the Kentucky Association of Plumbing, Heating and Cooling Contractors ("KAPHCC") raised questions regarding the affiliated interests of the merging entities. In the final Order in that proceeding the Commission stated that it had recently decided to open an administrative proceeding to explore Affiliate Transaction and Code of Conduct rules for

¹ Case No. 97-300, Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company for Approval of Merger.

all jurisdictional utilities.² The Commission is initiating this proceeding to consider a code of conduct for all utilities and affiliate transaction and cost allocation rules for the energy, water, and sewer utilities.

BACKGROUND

During the 1980s and 1990s, the creation of holding companies in the telecommunications, electric, and gas industries increased significantly. In the early 1980s the telecommunications industry began to diversify into regulated and non-regulated businesses. The Federal Communications Commission ("FCC") adopted specific rules and reporting requirements for local exchange carriers ("LEC") regarding cost allocations and affiliate interest reporting. The large LECs were required to develop Cost Allocation Manuals ("CAM") under FCC rules and submit those for FCC review and approval. Extensive audits were conducted by the FCC, state commissions, and jointly by the FCC and state commissions to assure compliance with the cost allocation procedures.

The Telecommunications Act of 1996 ("the Act") established certain accounting and auditing safeguards to assure that cross-subsidization does not occur in transactions between the Regional Bell Holding Companies ("RBOCs") and their unregulated affiliates. Section 272 of the Act provides for periodic audits by independent auditors to verify that no cross-subsidization occurs. Under the provisions of the Act the audits are to be reviewed by the state commissions and the FCC to assure that the objectives of

² Case No. 97-300, Order dated September 12, 1997, page 31.

the audits are being met.³ A joint task force of the FCC staff and representatives of the state commissions is continuing to develop audit procedures in anticipation of the initiation of these audits. The Kentucky Commission Staff has participated in the development of these procedures and will be involved in the audits as they begin in the BellSouth service area.

In December 1988, in Administrative Case No. 321,⁴ the Commission adopted standard cost allocation procedures for small telephone companies and adopted cost allocation manuals for Tier 1 telephone companies. A recent order issued by the Commission in Administrative Case No. 362⁵ updated the cost allocation procedures for all incumbent LECs.

Energy utilities that meet certain criteria have been regulated as registered holding companies by the United States Securities and Exchange Commission ("SEC") under the 1935 Public Utility Holding Company Act ("PUHCA"). Three of the major energy utilities operating in Kentucky -- Kentucky Power Company d/b/a American Electric Power, Columbia Gas of Kentucky, Inc., and The Union Light, Heat, and Power Company ("ULH&P") -- are affiliates of registered holding companies and subject to the oversight of the SEC. In the case approving the acquisition of control of ULH&P by CINergy, CINergy stated that under PUHCA, the SEC limits the circumstances and terms under

³ Telecommunications Act of 1996, Section 272.

⁴ Administrative Case No. 321, Separation of Costs of Regulated Telephone Service From Costs of Non-regulated Activities.

⁵ Administrative Case No. 362, Separation of Costs of Regulated Telephone Service From Costs of Non-regulated Activities.

which companies in a registered holding company system may perform services or construction for, or sell goods to, affiliated companies.⁶ PUHCA requires the creation of a service company if joint services are provided to the affiliated companies. Specific cost allocation methodologies are required, and the service agreements between the holding company and its affiliates require SEC approval. The SEC conducts periodic audits of the registered holding companies to assure that costs are allocated properly between the holding company and its affiliates. State regulatory commissions frequently participate in the SEC's audits of the registered holding companies.

Congress has discussed the need for PUHCA reform or repeal in light of the impending restructuring of the energy utility industry. The SEC staff has supported reform to the extent that oversight of holding companies would be continued by the Federal Energy Regulatory Commission ("FERC") and/or state regulatory commissions.

The FERC does not currently have specific cost allocation procedures to separate the regulated and non-regulated segments of a regulated utility, however, periodic audits conducted by the FERC could identify accounting discrepancies in reporting cost of service of the energy utility. The Federal Power Act contains a provision that approval would have to be obtained from the state regulatory commission before a FERC jurisdictional electric utility can enter a wholesale power sale agreement with an Exempt Wholesale Generation affiliate.

⁶ Case No. 94-104, Application of the Cincinnati Gas & Electric Company and CINergy Corp. for Approval of the Acquisition of Control of The Union Light, Heat and Power Company by CINergy Corp., page 12.

In Orders issued by the Commission over the past several years approving the creation of holding companies for major electric and gas utilities, the Commission has expressed its concerns about affiliate transactions. The Commission identified major areas of concern in an Order approving the acquisition of control of ULH&P by CINergy as (1) protection of utility resources, (2) the ability to adequately monitor corporate activities of the holding company and its affiliates, and (3) the filing of information to assist in monitoring.⁷ In that Order, as it has in Orders approving the creation of holding companies for LG&E and KU, the Commission established guidelines for affiliate transactions as well as accounting and reporting requirements to keep the Commission informed as to the affiliate activities and to assure that the transactions did not result in cross-subsidization between the affiliated entities.

In 1989 the Commission conducted proceedings in Administrative Case No. 326,⁸ wherein the issue of accounting for the satellite television affiliates of Rural Electric Cooperatives ("RECC") was addressed. In the final Order the Commission determined that the satellite television operations of the RECCs should be conducted through a separate subsidiary and that all costs borne by the RECC in connection with the satellite television operations should be properly allocated.

Kentucky-American Water Company ("Kentucky-American"), which serves Lexington, Kentucky and the surrounding area, is a subsidiary of the American Water

⁷ Id., page 10.

⁸ Administrative Case No. 326, An Investigation Into the Diversification of Rural Electric Cooperative Corporations Into the Satellite-Delivered Television Programming Services.

Works Company ("AWWC"). AWWC has a service company subsidiary that provides water testing and computer, purchasing, engineering, accounting and billing services for Kentucky-American and its other operating affiliates. Kentucky-American's 1989 agreement with the AWWC Service Company allocated all indirect costs to the operating subsidiaries based upon the number of customers each subsidiary served. In rejecting the 1989 Agreement for rate-making purposes, the Commission expressed its concern that an oversimplified allocation was selected that did not accurately track the costs but allocated them without separate consideration of the underlying characteristics of each cost.

PROCEDURES

Since the proliferation of holding companies began, regulatory commissions have dealt with the potential abuses that could occur through related party transactions in a variety of ways. Statutes have been enacted by some states and some commissions have recently undertaken proceedings to implement policies on affiliate transactions for energy utilities.

This proceeding is intended to lay the groundwork for Commission policy addressing the cost allocations, affiliate transactions and codes of conduct governing the relationships between regulated utilities and their non-regulated operations and/or affiliates. The two major areas of interest to be addressed in this proceeding are as follows:

1. Tools and conditions needed to prevent cost shifting and cross-subsidization between regulated and non-regulated operations. The Commission

has taken the position in cases approving the creation of holding companies that cost shifting should be prevented through provisions which allow access to the books and records of all non-regulated affiliates of public utilities. Policies regarding separation plans or operating agreements providing for the separation of utility and non-utility operations, resources, employees, and books and records should be addressed in this proceeding. Whether utilities should maintain written guidelines in the form of a CAM which should be filed with the Commission and updated when changes occur in the utility's operations should also be considered. This proceeding should address the issue of whether audits should be performed periodically by the Commission or by an independent auditor under the direction of the Commission to assure that the separation procedures are being followed.

2. Code of Conduct governing the regulated utility's interaction with non-regulated operations. The Commission intends to address the question of whether a code of conduct should be established to assure that the non-regulated segments of the holding company are not engaged in practices which result in unfair competition caused by cost shifting from the non-regulated affiliate to the utility. The code of conduct discussion should address sharing of information, databases and resources between employees involved in the marketing or provision of non-regulated services and those employees involved in the provision of regulated services. The code of conduct could include provisions for complete separation of the books and records, employees, financial arrangements, and may require transactions that are clearly at arm's length between the utility and its affiliates, including service companies.

The National Association of Regulatory Utility Commissioners, Staff Subcommittee on Accounts ("Staff Subcommittee") along with the Strategic Issues Subcommittee has developed a white paper on Accounting Safeguards for energy utilities which has been widely distributed among regulators and utilities. The above concerns are included in those guidelines. To facilitate discussion of the issues in this proceeding, Appendix A to this Order contains the complete text of that report as it was adopted by the Staff Subcommittee at its semi-annual meeting in March 1997.

The Commission encourages the participation of all utilities in this proceeding; however, it will limit mandatory participation to the large utilities. Appendix B contains a list of all utilities subject to the requirement to participate in these proceedings. The Commission suggests that the RECCs, Rural Telephone Cooperatives, and small utilities seek to form coalitions within their respective industries and select one spokesperson to represent their interests in this proceeding and to facilitate their participation with minimal cost. It should be made clear that all utilities under the Commission's regulatory jurisdiction, whether they participate in these proceedings or not, will be subject to the final decision in these proceedings if they have affiliate and/or unregulated operations.

To facilitate discussion on codes of conduct and affiliate transaction rules, and cost allocation rules, the Commission has included Appendix C to this Order which contains questions designed to obtain input on the cost allocation and codes of conduct and affiliate transaction issues. We request that each utility required to participate in these proceedings provide a thorough response to each of the questions or indicate why

the question is not applicable. An original and 12 copies of responses should be provided.

IT IS THEREFORE ORDERED that:

1. This proceeding is established to investigate the cost allocation and affiliate transaction rules for electric, gas, water, and sewer utilities and the code of conduct rules for all utilities operating in Kentucky that have non-regulated affiliates.

2. The Kentucky Association of Plumbing, Heating and Cooling Contractors shall be made a party to this proceeding.

3. Copies of this Order shall be served upon the Attorney General and the consumer groups typically involved in matters coming before the Commission.


4. Any other party wishing to intervene and participate in these proceedings shall submit a motion to intervene in accordance with the Commission's rules and regulations pertaining to such filings.

5. No later than January 15, 1998, the KAPHCC and each electric, gas, and water, sewer utility listed /in Appendix B to this Order shall file an original and 12 copies of the information request set forth in Parts I and II of Appendix C to this Order, with a copy to all parties of record.

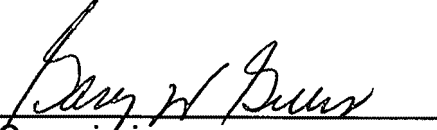
6. No later than January 15, 1998, each telecommunications utility listed in Appendix B to this Order shall file an original and 12 copies of the information requested in questions 1 through 13 of the information request set forth in Part I of Appendix C to this Order, with a copy to all parties of record.

Done at Frankfort, Kentucky, this 19th Day of December, 1997.

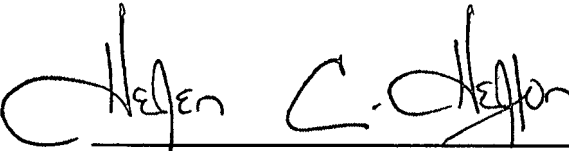
PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION
IN ADMINISTRATIVE CASE NO. 369 DATED December 19, 1997

Attached is the February 20, 1997 Memorandum from the Joint Task Force on Technical/Accounting Issues in Electric Industry Restructuring.

MEMORANDUM

TO: Members, NARUC Committee on Electricity
Members, NARUC Committee on Finance and Technology
Members, NARUC Subcommittee on Strategic Issues
Members, NARUC Legislative Task Force
Members, NARUC Subcommittee on Accounts
Members, NARUC Staff Subcommittee on Strategic Issues

FROM: Joint Task Force on Technical/Accounting Issues in Electric Industry
Restructuring

DATE: February 20, 1997

SUBJECT: Electric Restructuring Issues Paper

Last fall, the Subcommittee on Accounts and the Staff Subcommittee on Strategic Issues formed a task force to draft an issues paper addressing the relationship between the activities of regulated and non-regulated affiliated companies in a restructured electric utility industry. What prompted the formation of this task force was the recent experience of many state commissions in dealing with similar issues in the debate over the Telecommunications Act of 1996. The attached paper is intended to be used as a starting point for discussing these issues within NARUC. This paper is also intended to be a tool for state regulators on the issues of cost shifting and cross-subsidization.

The next step for the task force is to develop a resolution adopting this paper, which would work its way through the staff subcommittees and then on to the committees at the NARUC summer meetings. In the meantime, the task force is asking that you review the paper and offer any suggestions you might have.


The task force consists of the following staff members, who graciously volunteered their time:

Richard House, Arkansas PSC
Jan Karlak, Ohio PUC
Gary Mathis, Wisconsin PSC
Diane Braun, Wisconsin PSC
Sean Hunt, SEC

Tim Devlin, Florida PSC
Gary Forman, Kentucky PSC
Denise Parrish, Wyoming PSC
Bob Wason, SEC

Submitted on behalf of the task force by,


Donna Martin, Illinois Commerce Commission


Lou Ann Westerfield, Wyoming PSC

**TOOLS AND CONDITIONS NEEDED TO PREVENT COST SHIFTING AND CROSS
SUBSIDIZATION BETWEEN REGULATED AND NON-REGULATED AFFILIATES:**

Purpose: A utility may wish to provide competitive services through the regulated utility as either a regulated or non-regulated service or through a non-regulated subsidiary or affiliate. It is important that the law allow the Federal and State Commissions to employ the tools necessary to prevent cost shifting and to ensure the competitiveness in unregulated markets is not adversely affected by interactions with regulated markets. This cannot be guaranteed if the Commission must seek an agreement from a non-regulated subsidiary or affiliate in order to employ such tools.

A). Cost shifting between regulated and non-regulated affiliates shall be prevented through the following means:

- 1). Federal Access to Books and Records
The appropriate Federal Commission shall have access to all books, accounts and records of all non-regulated affiliates of a public utility.
- 2). State Access to Books and Records and Personnel capable of responding to inquiry from regulators
A State Commission may examine the books, accounts, memoranda, contracts and records and have access to personnel capable of responding to inquiries of:
 - a). a public utility subject to its regulatory authority under state law;
 - b). any non-regulated company, which is an affiliate, parent or subsidiary of the state-regulated public utility company selling or receiving products or services to and/or from the state-regulated public utility;
 - c). any non-regulated company which is an affiliate, parent or subsidiary of the state-regulated public utility company to determine if direct or indirect transactions have taken place between the non-regulated company and the state-regulated public utility. Where a State Commission accesses the books and records of a non-regulated affiliate company, the State Commission shall not publicly disclose trade secrets or sensitive

commercial information.

d). any Service Companies selling or receiving products or services to and/or from the state-regulated public utility;

e). any Service Companies to determine if direct or indirect transactions have taken place between the Service Company and the state-regulated public utility. Where a State Commission accesses the books and records of a non-regulated affiliate company, the State Commission shall not publicly disclose trade secrets or sensitive commercial information.

3). "Ordinary Course of Business" Contracts
The term "ordinary course of business", as it applies to contracts between affiliates that need not be approved by the Federal and State Commissions, should be clarified. It should be clarified that the transactions between the utility and the affiliate are for transactions which are customary for conducting regular utility business and that the goods or services being sold are typical for business transactions between a utility and another entity.

4). Separation plans or operating agreements

a). A separation plan or operating agreement shall be filed with and approved by the Federal and State Commissions which ensures, to the maximum extent practicable, the operations, resources, and employees involved in the provision or marketing of non-regulated services, and the books and records associated with those services shall be separate from the operations, resources, and employees involved in the provision of state-regulated services and the books and records associated with the state-regulated services.

b). Item 4).a). will apply even if the public utility company demonstrates a structural or physical separation of the regulated and non-regulated services.

c). Transactions between regulated and non-regulated service providers within the public utility company should be recorded in separate subaccounts to facilitate auditing by Federal and State Commission Staff.

5). Allocation of Costs

a). Public Utility companies should develop and maintain written guidelines for the methods used to allocate the costs of conducting and charging for or allocating transactions between regulated and non-regulated service providers within the public utility company. Such guidelines should be filed with and approved by the Federal and State Commissions.

b). Revenues received by state-regulated companies for services provided to non-regulated affiliates shall be recorded in "operating revenue" accounts, if corresponding costs were recorded in "operating expense" accounts.

c). Costs charged by regulated sectors to non-regulated sectors as affiliate transactions should be at fully allocated costs. In the case of a charge for facilities, the fully allocated costs should include at a minimum property taxes, depreciation expenses, maintenance expenses and a rate of return on the investment in the asset. In the case of personnel, the fully allocated costs should include all employee benefits, payroll taxes, insurance, pension and post retirement benefits other than pension.

d). In cases where costs cannot be charged directly and it is necessary to use an allocation formula, revenues should not be a factor in the formula unless the utility can prove a direct cause causation with the revenues. Generally, revenue based allocations are not based on cost causation or utilization of resources.

6). Audit Authority for State Commissions

The State Commission may order an audit to be performed no more frequently than on an annual basis, of all matters deemed relevant by the selected auditor that reasonably relate to retail rates.

a). The public utility company and the

affiliated or associated companies involved in non-regulated services shall cooperate fully with all requests necessary to perform the audit.

b). In the event the State ordered audit is performed by an independent auditor, the public utility company and its affiliates shall bear all costs of having the audit performed.

c). The audit report shall be provided to the State Commission not later than 6 months after the onset of the audit, and provided to the public utility company not later than 60 days thereafter.

d). Transactions between regulated and non-regulated sectors should be subjected to regular internal audits by the utility. These audits should test compliance with all Commission Orders, compliance with proper accounting procedures and compliance with the written guidelines. The audits should include written reports of conclusions which, along with associated workpapers, are to be made available to the Commission Staff for review.

B). Tools to protect competitiveness and avoid subsidized or predatory pricing in unregulated markets:

Purpose:

The same tools that the Federal and State Commissions need to prevent cost shifting also protect competitiveness of unregulated markets because they also prevent the non-regulated sectors from benefiting from lower costs than their competitors that result from shifting costs to regulated sectors.

In addition, non-regulated sectors or the regulated utility providing competitive services can benefit unfairly from free access to customer records of the regulated sectors. The non-regulated sectors, as well as the regulated public utility company, should be prohibited from unfair practices.

1). The regulated public utility company and its affiliates shall follow a code of conduct, filed with Federal and State Commissions, which governs the company's activities in a competitive market and the sharing of information, data bases and resources between its employees involved in the marketing or provision of non-regulated services and those employees involved in the provision of regulated services.

2). The public utility company and its affiliates shall maintain records subject to Federal and State Commission review, which document compliance with the code of conduct.

3). The Code of Conduct shall include, at a minimum, the following for any affiliate, including Service Companies engaged in competitive services:

a). affiliate shall operate independently from the Utility company;

b). affiliate shall maintain books, records, and accounts in the manner prescribed by the appropriate Federal and State Commissions which shall be separate from the books, records, and accounts maintained by the Utility company;

c). affiliate shall have separate officers, directors, and employees from the Utility company;

d). affiliate may not obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the Utility company; and

e). affiliate shall conduct all transactions with the Utility on an arm's length basis with any such transactions reduced to writing and available for public inspection.

4). The Code of Conduct should include, at a minimum, the following for the Utility who has an affiliate engaged in competitive services:

a). Utility may not discriminate between an affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or in the establishment of standards;

b). Utility shall account for all transactions with an affiliate in accordance with generally accepted accounting principals or accounting principals approved by the appropriate Federal and State Commissions; and

c). Utility shall not carry out any promotion, marketing, sales, advertising or research and development for or in conjunction with an affiliate.

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN ADMINISTRATIVE CASE NO. 369 DATED December 19, 1997.

TELEPHONE UTILITIES

Cincinnati Bell Telephone Company

GTE South Incorporated

BellSouth Telecommunications, Inc.

ELECTRIC UTILITIES

American Electric Power

Kentucky Utilities Company

Louisville Gas & Electric Company

The Union Light, Heat & Power Company

Big Rivers Electric Corporation

East Kentucky Power Cooperative, Inc.

GAS UTILITIES

Columbia Gas of Kentucky, Inc.

Delta Natural Gas Company, Inc.

Louisville Gas & Electric Company

The Union Light, Heat & Power Company

Western Kentucky Gas Company

WATER UTILITIES

Kentucky-American Water Company

APPENDIX C

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN ADMINISTRATIVE CASE NO. 369 DATED December 19, 1997.

PART I - Questions for KAPHCC, telephone, electric, gas and water utilities

1. Provide the following information concerning non-regulated affiliates or subsidiaries of the utility:

a. The name of the holding or parent company, if applicable. Indicate whether the holding or parent company is a registered holding company under the provisions of the Public Utility Holding Company Act of 1935.

b. The names of all non-regulated affiliate or subsidiary companies. Include with this listing any joint ventures in which the non-regulated affiliate or subsidiary company is participating.

c. For each listed non-regulated affiliate or subsidiary company, describe the nature of the business conducted by that company.

d. Provide a description of all services and products provided by the non-regulated affiliate or subsidiary.

2. Provide a description of all non-regulated services and products provided by the regulated utility.

3. Describe the facilities, employees, or other resources shared by regulated and non-regulated operations, affiliates, and subsidiaries.

4. Does the regulated utility engage in transactions with non-regulated divisions, affiliates, or subsidiaries? If so, explain the nature of each type of transaction. This discussion should include transfers from the regulated utility to the non-regulated entity and transfers from the non-regulated entity to the regulated utility.

5. Does the utility engage in any joint marketing or advertising with non-regulated divisions, affiliates or subsidiaries? If yes, describe the nature of this joint marketing or advertising.

6. Has the utility adopted practices or principles, commonly referred to as a "code of conduct," which governs the utility's and any non-regulated division's, affiliate's, or subsidiary's activities in a competitive market and the sharing of information, databases, and resources between the utility's employees involved in the marketing or provision of non-regulated services and those employees involved in the provision of regulated services?

a. If yes, when was this code of conduct adopted by the utility?

b. Is the code of conduct a written document? If yes, provide copies of the current code of conduct. If no, explain why the code of conduct is not a written document.

7. Discuss whether a regulated utility should be required to operate independently from an affiliate or subsidiary.

8. Discuss whether a regulated utility should be prohibited from sharing officers, directors, and employees with an affiliate or subsidiary.

9. Discuss whether a regulated utility should be prohibited from providing favorable treatment to a non-regulated division, affiliate, or subsidiary in the provision or procurement of goods, services, facilities, or information.

10. Discuss whether a regulated utility should be prohibited from joining with a non-regulated division, affiliate, or subsidiary in promotional, marketing, sales, advertising, or research and development activities.

11. Comment on the need for royalty payments from a non-regulated division, affiliate, or subsidiary to a utility for the use of intangible benefits including the utility's name or logo.

12. Should a code of conduct be the same for large and small companies or should this proceeding be bifurcated into large companies and small companies? Which companies should be included in each classification and why?

13. Should the Commission have access to the books and records of a utility's affiliate or subsidiary company to ensure that transactions between the two entities comply with the rules established in this case? If no, why not?

PART II - Questions for KAPHCC, electric, gas, and water utilities

14. Describe the cost allocation procedures the utility currently has in effect. The description should address, but not be limited to, the following questions:

a. During the most recent 12-month period, approximately what percentage of costs were allocated on a direct assignment basis?

b. Describe the types of costs the utility usually allocates on the basis of direct assignment.

c. Provide a list of the cost allocation methods, other than direct assignment, the utility currently uses. Include a brief description of each method, the basis of the allocation, and the types of costs usually allocated using the method.

d. Indicate when cost allocation principles were last reviewed for reasonableness or appropriateness by the utility.

e. Are the utility's cost allocation procedures subject to rules or guidelines established by federal agencies, such as the SEC?

15. Has the utility developed a written cost allocation manual ("CAM")?

a. If so, provide a copy of the CAM. If a written manual does not exist, explain why the utility's procedures have not been documented.

b. When was the utility's CAM last updated?

16. If a time-reporting method of allocation is in use, indicate if the method is based on:

a. The actual time reported for a period, such as a month, quarter, or year.

b. An estimate of how time will be reported for a period.

c. Statistical samples of employee time.

d. Some other approach.

17. Concerning transfers between the utility and non-regulated division, affiliate, or subsidiary, describe how the following transactions are priced:

a. Transfers of goods or services from the utility to the non-regulated entity.

b. Transfers of good or services from the non-regulated entity to the utility.

c. Transfers of assets from the utility to the non-regulated entity.

d. Transfers of assets from the non-regulated entity to the utility.

18. Describe in detail how market value or fair market value is determined for transactions between the utility and non-regulated divisions, affiliates, or subsidiaries that are priced at market.

19. In transactions between the utility and non-regulated divisions, affiliates or subsidiaries, is cost plus pricing ever used? If yes, indicate the types of transactions this pricing method is used for and explain why the method is used.

20. Are any of the transactions between the utility and non-regulated divisions, affiliates, or subsidiaries covered by contracts, memoranda of understanding, or other agreements? If yes, for each circumstance,

a. Identify the parties to the agreement.

b. Describe the transactions covered by the agreement, as well as other terms and conditions.

c. Explain why the parties decided that these transactions should be covered by contract, memoranda of understanding, or other agreement, rather than applying established cost allocation practices.

21. Are cost allocation practices and transactions between the utility and non-regulated divisions, affiliates or subsidiaries the subject of internal audits or audits by the utility's independent external auditor? If yes, for the most recent 12-month period, provide the following:

a. Describe the reviews performed through internal audits or by the independent external auditor.

b. Indicate whether the reviews identified areas which needed correction or improvement. Describe the utility's response to these reviews.

22. Are cost allocation rules necessary to ensure proper accounting for investments, expenses, and revenues when utilities engage in both regulated and non-regulated activities? Explain your response.

a. Would establishment of cost allocation rules help protect ratepayers from cross-subsidization? Discuss your response.

b. Would establishment of cost allocation rules affect competition in the non-regulated portion of your business? Discuss your response.

c. Are there possible situations in which the Commission should require that an unregulated activity be provided by a structurally separate affiliate rather than rely on non-structural safeguards, such as accounting rules? For example, there are laws which require that electric utility holding companies provide telecommunications services through a separate affiliate. Are there similar laws for other electric utilities? If not, should the Commission require that some types of services, such as telecommunications, be provided only by a structurally separate affiliate?

23. The FCC established cost allocation procedures for the telephone industry. Comment on the applicability of the following procedures for energy and investor-owned water utilities:

a. Directly Assignable - costs or resources used exclusively to provide either regulated or non-regulated activities are assigned directly to that activity.

b. Directly Attributable - costs or resources common to both regulated and non-regulated activities which cannot be directly assigned, which are allocated using a direct measurement of cost causation.

c. Indirectly Attributable - costs or resources common to both regulated and non-regulated activities which cannot be directly assigned or allocated, which are allocated based on an indirect measurement of cost causation.

d. Unattributable - costs or resources common to both regulated and non-regulated activities which cannot be directly assigned, directly attributed, or indirectly attributed which are allocated using a general allocator based on all previously allocated regulated versus non-regulated expenses.

24. The FCC established affiliated transaction procedures for the telephone industry. Comment on the applicability of the following procedures for energy and investor-owned water utilities:

a. Transfers of goods and services from the affiliate to the regulated utility to be at invoice price if item is held out to the public in the normal course of business. If prevailing price is not available, transfers are to be priced at the lower of the cost of the item less its valuation reserves or fair market value.

b. Transfers of goods and services from the regulated utility to the affiliate are to be priced at the tariffed rate. If not a tariffed item, transfers are to be priced at the higher of the cost of the item less its valuation reserves or fair market value.

25. If guidelines governing affiliated transactions are adopted, comment on the need to allow a utility to file an application requesting deviation from standardized pricing policies.

26. If energy and investor-owned water utilities are required to file written cost allocation manuals with the Commission:

a. Should a utility be required to file changes to its CAM at the time the changes are made and to receive prior approval for such changes?

b. Should the Commission treat any portion of a company's CAM as proprietary? If yes, what portions should be proprietary and what section of the Kentucky Open Records Act would justify this treatment?

c. Should a standardized CAM be developed for each industry group to be used by small companies instead of requiring each small company to develop its own CAM? If so, who should develop these standardized CAMs for each industry group?

27. Should cost allocation rules be the same for large and small companies or should this proceeding be bifurcated into large companies and small companies? Which companies should be included in each classification and why?

28. Should investments, expenses, and revenues associated with incidental non-regulated service be accounted for as if the service were regulated?

a. If so, explain why and indicate how incidental non-regulated service should be defined.

b. If not, explain why this would not be appropriate.

29. How could the Commission ensure that costs allocated to a jurisdictional utility from an out-of-state holding company do not include non-regulated activities?

30. If cost allocation is at issue in a formal proceeding with the Commission, comment on whether the party with the burden of proof should be required to perform

a cost study to determine compliance with any Commission cost allocation requirements that may be adopted. Comment on the utility's responsibility to provide information sufficient to enable another party to perform a cost study.