COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ADJUSTMENT OF GAS RATES OF THE UNION LIGHT, HEAT AND POWER COMPANY	))	CASE NO. 2001-00092

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O R D E R

The Union Light, Heat and Power Company (ULH&P), a wholly owned subsidiary of The Cincinnati Gas and Electric Company (CG&E),[1] is an electric and gas utility that purchases, sells, stores, and transports natural gas in Boone, Campbell, Gallatin, Grant, Kenton, and Pendleton counties in Kentucky.[2] As of September 30, 2000, ULH&P had 83,363 natural gas customers.[3]

BACKGROUND

On March 29, 2001, ULH&P filed a letter giving notice of its intent to file an application for approval of an increase in its gas rates to produce additional annual revenues of $7,252,472, an increase of 8.4 percent. On May 4, 2001, ULH&P filed its application. The application contained deficiencies, which ULH&P subsequently cured,

[1] ULH&P is a Kentucky corporation and one of three wholly-owned utility subsidiaries of CG&E. CG&E is an Ohio corporation and a public utility subsidiary of Cinergy Corp. (Cinergy), a registered public utility holding company that was created in October 1994.

[2] ULH&P distributes and sells electricity in Boone, Campbell, Grant, Kenton, and Pendleton counties in Kentucky.

[3] For the same period, ULH&P had 123,884 electric customers. See ULH&P s Response to the Commission Staff s Third Data Request dated September 4, 2001, Item 3.

and the application was considered filed as of June 6, 2001.[4] ULH&P s application includes a proposal to establish an Accelerated Main Replacement Program (AMRP) Rider, a tracking mechanism that will permit ULH&P to recover the costs of its accelerated cast iron and bare steel main replacement program. To determine the reasonableness of the request, the Commission suspended the proposed rates for 5 months from their effective date pursuant to KRS 278.190(2) up to and including December 5, 2001. ULH&P voluntarily extended this suspension until January 15, 2002.[5]

The Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention (AG), requested and was granted full intervention.[6]

On June 21, 2001, the Commission issued a procedural schedule to investigate ULH&P s rate application.[7] The schedule provided for discovery, intervenor testimony, rebuttal testimony by ULH&P, a hearing, and an opportunity for the parties to file post-

[4] The Commission rejected ULH&P s May 4, 2001 filing due to deficiencies noted by letter dated May 22, 2001. On June 6, 2001, ULH&P filed information in response to the deficiency letter, which the Commission determined cured the noted deficiencies.

[5] On July 27, 2001, ULH&P filed a motion requesting an extension of 3 weeks to respond to various data requests. In its motion, ULH&P acknowledged that the extension would require the modification of the procedural schedule established by the Commission s June 21, 2001 and July 13, 2001 Orders. ULH&P stated that if the requested extension of time were granted, it would not implement its proposed rates prior to January 15, 2002. The Commission granted the requested extension by Order dated August 6, 2001.

[6] Stand Energy Company filed a motion to intervene on August 6, 2001. However, the Commission denied this motion by Order dated August 10, 2001 and denied reconsideration by Order dated September 13, 2001.

[7] The procedural schedule was subsequently amended by Commission Orders dated July 13, 2001, August 6, 2001, and August 30, 2001.

hearing briefs. ULH&P filed its rebuttal testimony on November 13, 2001. ULH&P s rebuttal testimony contained revisions to several exhibits and proposed to update its capitalization to reflect balances as of September 30, 2001. These revisions indicated that ULH&P s requested increase in annual revenues should be $7,006,120 rather than the $7,252,472 originally proposed.[8] ULH&P s rebuttal testimony also included a proposal to establish an earnings sharing mechanism in conjunction with its proposed AMRP Rider. On November 21, 2001, the AG filed a motion to strike the earnings sharing mechanism testimony. The Commission granted the AG s motion to strike the earnings sharing mechanism rebuttal testimony at the hearing held at the Commission s offices in Frankfort, Kentucky on November 28 and 29, 2001.[9]

The procedural schedule provided for post-hearing briefs to be submitted by December 18, 2001. Both parties timely filed briefs and the case now stands submitted for a decision.

<u>TEST PERIOD</u>

ULH&P proposes the 12-month period ending September 30, 2000 as the test period for determining the reasonableness of the proposed rates. The AG also utilized this 12-month period. The Commission finds it is reasonable to utilize the 12-month period ending September 30, 2000 as the test period in this proceeding. In utilizing a

[8] Smith Rebuttal Testimony, Rebuttal PGS-1, page 1 of 8. Further, in ULH&P s responses to hearing data requests, ULH&P recognized the impact the use of a lower effective Kentucky income tax rate would have on its proposed revenue increase. Based on this information, ULH&P determined the increase would be $6,690,249. <u>See</u> ULH&P s Response to the Commission Staff s Hearing Requests, Item 13.

[9] Transcript of Evidence (T.E.), Volume I, November 28, 2001, at 13-14.

historic test period, the Commission has given full consideration to appropriate known and measurable changes.

However, the Commission is concerned that approximately 7 months had passed between the end of the proposed test period and the filing of ULH&P s application. ULH&P testified that its rate application had been ready for filing in January 2001, but decided to delay filing at that time because there were many, many newspaper articles and a lot of bad publicity about the rising cost of gas and, quite bluntly, in deference to that, we chose to hold up the filing for a couple of months to see where that was going and to get that behind us.[10] ULH&P agreed that the data should be as good as possible, but it believes the delay was a good decision given the circumstances. ULH&P noted that the Commission has accepted applications with test periods older than the 7 months existing in this case.

While the Commission may have in the past accepted rate case applications with older test periods, ULH&P should not have relied on that fact to justify the time lapse in this case. When ULH&P decided to delay the filing of its application, it should have considered using a more current test period, such as the 12-months ending December 31, 2000. However, as stated above, the Commission in this case will accept the use of the 12-month period ending September 30, 2000 as the test period in this case. In future rate case applications where a historical test period is utilized, the Commission will expect a more current test period to be used.

[10] Id. at 203-204.

RATE BASE

In its application, ULH&P proposed an adjusted jurisdictional gas rate base of $115,214,653, which it revised in its rebuttal testimony to $111,603,466.[11] The AG proposes an adjusted jurisdictional gas rate base of $108,968,790.[12] Both ULH&P and the AG utilized these jurisdictional gas rate bases to determine their respective jurisdictional rate base ratios, which were applied to ULH&P s total company jurisdictional capitalization to determine ULH&P s jurisdictional gas capitalization. ULH&P originally determined its jurisdictional rate base ratio to be 39.760 percent, but in its rebuttal testimony revised the ratio to 42.636 percent.[13] The AG determined the jurisdictional rate base ratio to be 42.092 percent.[14]

In previous Commission decisions when a jurisdictional rate base ratio has been utilized, the rate base used to calculate the ratio has not been the same as the rate

[11] During discovery, ULH&P indicated that it had not properly handled certain accumulated deferred income taxes when calculating its jurisdictional gas rate base. In its rebuttal testimony, ULH&P corrected this error as well as adjusted the balances used for the cash working capital allowance, other rate base items, and accumulated deferred income taxes. See Application Workpaper WPD-2.10b and Smith Rebuttal Testimony, Rebuttal PGS-3, page 2 of 2.

[12] Henkes Direct Testimony, Schedule RJH-4.

[13] Application Workpaper WPD-2.10b and Smith Rebuttal Testimony, Rebuttal PGS-3, page 1 of 2.

[14] Henkes Direct Testimony, Schedule RJH-4.

base used for rate-making purposes.[15] The jurisdictional rate base ratio reflects the jurisdictional rate base as of test-year end before recognizing rate-making adjustments applicable to either electric or gas operations. Neither ULH&P nor the AG have argued in this case that the Commission should depart from its previous approach in determining the jurisdictional rate base ratio.

Jurisdictional Rate Base Ratio

The Commission has reviewed the proposed jurisdictional gas rate base ratios and has made the following modifications:

Other Materials and Supplies. In determining the total company jurisdictional rate base, ULH&P and the AG include $692,525 as the 13-month average balance for Other Materials and Supplies, with $286,282 allocated to jurisdictional gas operations. Included in this average balance is the 13-month average balance for Account No. 163 Stores Expense Undistributed. Both ULH&P and the AG allocated 41.34 percent of the 13-month average balance to jurisdictional gas operations.[16] However, a review of ULH&P s trial balance as of test-year end identifies Account No. 163 as Stores Expense

[15] See Case No. 91-370, Application of The Union Light, Heat and Power Company to Adjust Electric Rates, final Order dated May 5, 1992, at 9 and Appendix B; Case No. 92-346, The Application of The Union Light, Heat, and Power Company for an Adjustment of Rates, final Order dated July 23, 1993, at 10 and Appendix B; Case No. 98-426, Application of Louisville Gas and Electric Company for Approval of an Alternative Method of Regulation of Its Rates and Service, final Order dated January 7, 2000, at 63 and Appendix B; and Case No. 2000-080, The Application of Louisville Gas and Electric Company to Adjust Its Gas Rates and to Increase Its Charges for Disconnecting Service, Reconnecting Service and Returned Checks, final Order dated September 27, 2000, at 23 and Appendix C.

[16] Application Workpaper WPB-5.1c.

Electric Distribution.[17] ULH&P s jurisdictional gas rate base should not include amounts that are related to its electric operations. Therefore, the Commission has allocated 100 percent of the 13-month average balance for Account No. 163 to ULH&P s jurisdictional electric rate base. The Commission has included $135,355 as the 13-month average balance for Other Materials and Supplies in the jurisdictional gas rate base.

PSC Assessment. ULH&P s total company jurisdictional and jurisdictional gas rate bases include the 13-month average balance for its PSC Assessment as a prepayment. ULH&P acknowledges that the Commission in previous cases has not included the PSC Assessment as a prepayment in rate base. However, it argues that the assessment is for the purpose of maintaining the operations of the Commission and that the assessment is paid prior to the period to which it applies.[18] ULH&P reasons that the PSC Assessment should be included in its respective rate bases because it represents a cash outlay for a prepaid expense and should be treated as other prepaid items.[19]

The AG removed the 13-month average balance of the PSC Assessment from his determination of jurisdictional gas rate base, but retained the PSC Assessment in the determination of his jurisdictional electric and total company jurisdictional rate

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[17] ULH&P s Response to the Commission Staff s First Data Request dated April 25, 2001, Item 9(a), page 10 of 16 and Item 10, page 1 of 8.

[18] ULH&P Brief at 18.

[19] ULH&P s Response to the Commission Staff s Second Data Request dated July 10, 2001, Item 19.

bases.[20] The AG argues that consistent with previous Commission practice, the PSC Assessment should be excluded from the prepayment balance included in the jurisdictional gas rate base calculation.[21] The AG contends that in order to properly achieve the Commission s desired rate-making effect on gas operations, it is appropriate to include the PSC Assessment in the jurisdictional electric and total company jurisdictional rate bases. He further argues that if the PSC Assessment is excluded from all rate base calculations, the only way to reflect that exclusion when determining ULH&P s jurisdictional gas capitalization is to treat the amounts related to the PSC Assessment as a non-jurisdictional capital component. This non-jurisdictional component should then be excluded from total company capitalization before applying the jurisdictional rate base ratio.[22]

In three previous ULH&P cases,[23] the Commission has rejected the inclusion of the PSC Assessment in the determination of rate base, and we are not persuaded by ULH&P s current argument. In its current argument, ULH&P notes that the PSC Assessment is a maintenance tax levied on its gross receipts. ULH&P is notified on or before July 1 of each year of the amount assessed against it, and the assessment is due and payable on or before July 31 of that same year. As such, the annual

[20] Henkes Direct Testimony, Schedule RJH-4.

[21] Id. at 27.

[22] AG s Response to the Commission Staff s First Data Request dated October 18, 2001, Item 2.

[23] See Case No. 90-041, An Adjustment of Gas and Electric Rates of The Union Light, Heat and Power Company, final Order dated October 2, 1990, at 10; Case No. 91-370, May 5, 1992 Order at 4-5; and Case No. 92-346, July 23, 1993 Order at 4-5.

assessment is a liability that ULH&P must pay each year, not unlike its state and federal income taxes. ULH&P s payment of this liability does not constitute the prepayment of an expense.

The assessment is due by a specific date, which is no less than a month after ULH&P is notified of the current year s assessment. ULH&P appears to be arguing that since the assessment provides the funding of the Commission s ongoing operations, this establishes the payment of the assessment as a prepayment. The proper accounting classification of this transaction should be dependent upon what the payment of the PSC Assessment represents to ULH&P and not the fact that the Commission s ongoing operations are funded by it.

The Commission believes that the payment of the PSC Assessment is more like the payment of a tax liability, like income taxes, rather than the prepayment of an expense, like insurance. While the Commission will not require ULH&P in this case to change its accounting for its payment of the PSC Assessment, it should include in its next rate case a narrative explanation of why the PSC Assessment should not be recorded as an accrued liability rather than a prepayment.

The Commission also does not accept the AG s argument that the PSC Assessment should only be excluded from the jurisdictional gas rate base. The AG appears to believe that this exclusion is related solely to determining the jurisdictional rate base ratio. This is not a correct assumption. In previous cases, the Commission has excluded the PSC Assessment from the determination of the jurisdictional rate bases used to determine the jurisdictional rate base ratio.[24] In those cases, the Commission determined that it was inappropriate and unreasonable for the utility to earn a return on the PSC Assessment as well as recover the assessment through rates. The Commission believes it is reasonable and appropriate that this determination apply to the calculation of the jurisdictional rate bases for ULH&P s gas operations and the total company.

The AG s argument is also based on the assumption that rate base and capitalization are equal. However, while accepting this theoretical concept, the Commission has long recognized that a utility s rate base is rarely equal to its capitalization. This is the situation in the current case. There are numerous reasons why rate base and capitalization are not equal. There has been no evidence provided to establish that the PSC Assessment has been funded exclusively with capital. Thus, the Commission does not agree with the AG s suggestion that the amount of the PSC Assessment removed from the jurisdictional rate base calculations should be treated as a non-jurisdictional adjustment that is removed from the capitalization.

Therefore, the Commission finds that it is appropriate to exclude the PSC Assessment from the 13-month average balance of prepayments included in the determination of the jurisdictional gas rate base and the total company jurisdictional rate base.

Deferred Assets   Merger-Related Costs and 1992 Downsizing. ULH&P proposes to include in its jurisdictional gas rate base and the total company

[24] See Case No. 91-370, May 5, 1992 Order, Appendix B; Case No. 92-346, July 23, 1993 Order, Appendix B; and Case No. 2000-080, September 27, 2000 Order, Appendix C.

jurisdictional rate base the unamortized balances of certain Cinergy merger-related costs and costs associated with its 1992 downsizing program.[25] Concerning the Cinergy merger-related costs, ULH&P argues for rate base inclusion of these deferred costs because the costs were incurred for the purpose of providing more efficient service to ratepayers and that it has had no opportunity to either recover the costs or earn a return on the unamortized balances. ULH&P also contends that the inclusion of these costs in rate base will provide utilities with an incentive to undertake other cost-cutting measures. Regarding the 1992 downsizing costs, ULH&P argues that the stated reasons for including the Cinergy merger-related costs are also applicable to the 1992 downsizing costs. ULH&P also argues that since it has shouldered the burden of this cost cutting measure since 1993, it is now the ratepayers turn to shoulder the burden.[26]

The AG opposes the inclusion of the deferred assets associated with merger-related costs and the 1992 downsizing costs in ULH&P s jurisdictional gas rate base. The AG notes that ULH&P deferred these merger-related costs between 1994 and 1996 on its books, but has not amortized those balances. The AG states that ULH&P has admitted that it did not seek the prior approval of the Commission to create these deferrals. While the AG acknowledges ULH&P s claim that the Commission has permitted the deferral and amortization of similar costs, he argues that the proposed rate-making treatment for the merger-related deferrals does not reflect Commission

[25] The Cinergy merger-related costs are identified as merger costs to achieve savings, merger transaction costs, and merger costs to achieve savings related to the 1994 Voluntary Early Retirement Program (1994 VERP). The Commission authorized the amortization of the 1992 downsizing program in Case No. 92-346. See Case No. 92-346, July 23, 1993 Order, at 26-27 and Appendix D.

[26] ULH&P Brief at 15-17.

practice. The AG also notes that neither the merger-related costs nor the associated savings resulting from the merger and the 1994 VERP have been recognized in ULH&P s rates. Concerning the 1992 downsizing costs, the AG argues that the Commission has already determined that the unamortized balance of this deferral should not be included in the jurisdictional gas rate base, and ULH&P has provided no justification to change that decision in this case.[27] As with the PSC Assessment, the AG proposes that these deferred assets should be excluded from the jurisdictional gas rate base, but included in the total company jurisdictional rate base. The AG s proposal is based on the same reasoning used for the treatment of the PSC Assessment.[28]

The Commission is not persuaded by the arguments of ULH&P for including either the merger-related costs or the 1992 downsizing costs. In previous energy utility decisions, the Commission has not allowed both the recovery of costs through amortization and the earning of a return on the unamortized deferred asset balances. The Commission articulated its reasoning in ULH&P s last gas rate case when it stated:

> To allow amortization of the costs and a return on the unamortized portion would inappropriately shift the expense of downsizing solely to the ratepayers. As both the ratepayers and shareholders should enjoy future benefits from downsizing, they should share its concomitant expenses. This can be accomplished by excluding any return on the unamortized portion of the downsizing costs.[29]

The Commission believes that this reasoning is still valid, and no evidence or argument has been provided in this proceeding that convinces us otherwise. ULH&P s argument

[27] Henkes Direct Testimony at 15-19.

[28] AG s Response to the Commission Staff s First Data Request dated October 18, 2001, Item 2.

[29] Case No. 92-346, July 23, 1993 Order at 7.

that it has had no opportunity to either recover the costs or earn a return on the unamortized balances of the merger-related costs is unfounded. The failure to have an opportunity to recover the merger-related costs rests with ULH&P, as it has decided when general rate cases would be filed before the Commission. For energy utilities, the Commission in several previous cases has not authorized the earning of a return on the unamortized balance in order to achieve a sharing of the cost burden between ratepayers and shareholders. Further, the Commission believes ULH&P s incentive argument is not relevant to this issue. ULH&P and its parent CG&E proceeded with the creation of Cinergy without such incentives from this Commission. ULH&P s belief that it alone has shouldered the 1992 downsizing costs is incorrect, for it has recovered the amortization expense for the downsizing through rates since 1993.

As with the PSC Assessment, the Commission is not persuaded by the AG s arguments that these deferred assets should be excluded from the jurisdictional gas rate base but included in the total company jurisdictional rate base. The AG has not offered any argument that justifies one approach for computing the jurisdictional gas rate base and a different approach for computing the total company jurisdictional rate base. Likewise, the AG has not established that these deferred assets were funded solely by capital, and the Commission will not treat the amount of these deferred assets as a non-jurisdictional adjustment that is removed from the capitalization.

Therefore, the Commission will exclude from the determination of both the jurisdictional gas rate base and the total company jurisdictional rate base the deferred assets associated with the Cinergy merger-related costs and the 1992 downsizing costs. The amortization of these costs is discussed later in this Order.

The Commission is also concerned that ULH&P deferred the Cinergy merger-related costs and created deferred assets without prior Commission approval. Contrary to ULH&P s belief,[30] the Commission s approval of Cinergy s acquisition of control over ULH&P in Case No. 94-104[31] did not authorize the creation of these deferred assets. Therefore, the Commission finds that in the future, ULH&P shall formally apply for Commission approval before accruing a cost as a deferred asset, regardless of the rate-making treatment that the Commission has afforded a similar cost in previous rate case proceedings. The Commission will consider each deferred cost proposal independently and consider the circumstances associated with each proposal.

Accumulated Depreciation. Both ULH&P and the AG recognized in the determination of their respective jurisdictional rate base ratios the normalization of test year depreciation expense for both gas and electric operations. The normalization of the gas depreciation expense was determined by ULH&P to be a reduction of $465,727 while the electric depreciation expense was determined to be a reduction of $481,242.[32]

Consistent with the approach used by the Commission in previous rate cases, we will not recognize the depreciation normalization adjustment in the determination of the jurisdictional rate base ratio. The Commission usually recognizes this normalization as

[30] T.E., Volume I, November 28, 2001, at 106-107. At the hearing, ULH&P stated its belief that the Commission s Order in Case No. 94-104 allowed it to seek recovery of the merger-related costs in its next gas rate case. No citation to the Commission s May 13, 1994 Order in Case No. 94-104 was provided supporting that belief.

[31] 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 & Power Company by Cinergy Corp., final Order dated May 13, 1994.

[32] Application Workpaper WPB-6a.

an adjustment to the accumulated depreciation balance included in the rate base used for rate-making purposes. It is not recognized when the jurisdictional rate base ratio is being determined. In addition, there is no evidence in the record supporting ULH&P s statement that a normalization of its electric depreciation expense for the 12 months ending September 30, 2000 results in a reduction of $481,242.

However, when determining the jurisdictional gas rate base for rate-making purposes, the Commission will recognize as an adjustment to the accumulated depreciation balance the test-year normalization of ULH&P s gas depreciation expense, as found reasonable in this Order.

Allowance for Funds Used During Construction Adjustment. In determining the total company jurisdictional rate base and the jurisdictional gas rate base, ULH&P included the Allowance for Funds Used During Construction (AFUDC) Offset to Net Operating Income (AFUDC Offset). ULH&P increased its jurisdictional gas rate base by $117,260.[33] ULH&P contends this item should be included in the determination of the rate base because:

> AFUDC is comparable to depreciation in that both of those affect the original cost net plant balance. Depreciation adjustments typically are reflected as one half of that amount adjusted to the rate base. Correspondingly, an AFUDC adjustment should increase rate base by one half of that amount. Again, the logic holds between both depreciation and AFUDC. They affect rate base comparably. Therefore adjustments of those two items should affect rate base comparably.[34]

[33] ULH&P later concluded that the adjustment should reflect an incremental increase, and accepted a calculation provided by the AG of an increase of $48,935. See Smith Rebuttal Testimony at 5 and the AG s Response to ULH&P s First Data Request dated October 18, 2001, Item 47.

[34] T.E., Volume I, November 28, 2001, at 103.

The AG opposes the inclusion of the AFUDC Offset in the determination of the jurisdictional gas rate base and the total company jurisdictional rate base. He argues the Commission has never allowed a similar adjustment to rate base in previous cases. The AG also contends the original adjustment proposed by ULH&P is conceptually flawed, incorrectly calculated, and significantly overstated.[35]

The AFUDC Offset is necessitated by how Construction Work in Progress (CWIP) is treated in the determination of the utility s rate base. The Commission has determined in previous cases that If a utility is allowed to include the balance of all CWIP including the CWIP subject to AFUDC in its rate base at test-year end, a corresponding adjustment must be recognized in the revenue requirements to achieve proper matching. [36] Because all CWIP is included in ULH&P s jurisdictional gas rate base, it will have the opportunity to earn a return on that CWIP, even the CWIP subject to AFUDC. The inclusion of the AFUDC Offset in rate base would allow ULH&P the opportunity to earn a return on an adjustment to revenue requirements that resulted from ULH&P being allowed the opportunity to earn a return on CWIP subject to AFUDC.

[35] Henkes Direct Testimony at 31.

[36] Case No. 92-346, July 23, 1993 Order, at 36-37.

Although previously requested,[37] ULH&P did not explain the reasons for this proposed AFUDC Offset until the hearing. Even then, ULH&P s response was not adequate to persuade the Commission that this item should be included in the determination of rate base. The Commission neither agrees with the logic expressed by ULH&P in its response at the hearing nor finds the rationale compelling. Depreciation is a means to recognize the loss in service value of plant in service over time. AFUDC reflects the capitalization of the cost of borrowed funds used for construction as part of the original cost of utility plant. The two concepts are related in that AFUDC increases the total recorded cost of utility plant in service that will be depreciated over the service life of the asset. Concerning the remainder of ULH&P s explanation, it has not provided any justification or support for its contention that depreciation adjustments to rate base are reflected as one half of the amount adjusted to rate base.

Therefore, the Commission will not include the AFUDC Offset in the determination of the total company jurisdictional rate base or jurisdictional gas rate base for ULH&P.

Accumulated Deferred Income Taxes. ULH&P s jurisdictional gas rate base includes accumulated deferred income taxes (ADIT) totaling $11,591,971.[38] The AG

[37] See ULH&P s Response to the Commission Staff s Second Data Request dated July 10, 2001, Item 22(e); ULH&P s Response to the Commission Staff s Third Data Request dated September 4, 2001, Item 16(h); and T.E., Volume I, November 28, 2001, at 101-103. In the Commission Staff s Second and Third Data Requests, ULH&P was specifically asked to explain the reasons for the proposal, why it should be included in rate base, and indicate whether the Commission had previously made such an adjustment. ULH&P s reply to both data requests was that it had agreed with the AG that the amount to be included in rate base should be an incremental amount.

[38] Application Workpaper WPB-2.10b.

contends that the appropriate balance to include is $15,113,734.[39] The AG argues that the ADIT associated with unbilled revenues and losses on reacquired debt should be removed from the ADIT balances included in rate base. Upon review, ULH&P agrees with the AG on the treatment of these ADIT balances.[40] The Commission is also persuaded that the ADIT treatment proposed by the AG for unbilled revenues and losses on required debt is reasonable and will be reflected in the determination of the jurisdictional rate base ratio and the jurisdictional gas rate base.

The Commission has made two additional adjustments to the ADIT balance used in the determination of ULH&P s jurisdictional rate base ratio and jurisdictional gas rate base. The first involves Unrecovered Purchased Gas Cost ADIT in the amount of $520,795. ULH&P has removed this ADIT balance from the determination of its jurisdictional gas rate base. While the Commission agrees with this adjustment, it is a rate-making adjustment only, and should not be reflected in the determination of the jurisdictional gas rate ratio. Therefore, the Commission will include the Unrecovered Purchased Gas Cost ADIT balance when determining the test-year-end rate base utilized to calculate the jurisdictional rate base ratio.

The second adjustment relates to ADIT associated with Statement of Financial Accounting Standards No. 109 (FAS 109). In its application, ULH&P classified its entire balance of ADIT associated with FAS 109 as non-jurisdictional.[41] ULH&P argues

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[39] Henkes Direct Testimony, Schedule RJH-4.

[40] ULH&P s Response to the AG s First Data Request dated July 10, 2001, Item 16.

[41] Application Workpaper WPB-6a.

the ADIT associated with FAS 109 reflects neither a source or use of funds nor an investment in utility property. Based on this premise, ULH&P contends that the ADIT associated with FAS 109 should not be considered for rate-making purposes.[42] At the hearing, ULH&P acknowledged that it was not familiar with how the Commission had treated ADIT associated with FAS 109 in other rate proceedings, but it was familiar with the treatment in Indiana and Ohio.[43] While the AG originally inquired about the ADIT associated with FAS 109, he did not include this item in his determination of ULH&P s rate base.

All ADIT result from differences relating to when the effects of an accounting transaction are recognized in the determination of net book income and taxable income. These timing differences between book and tax accounting treatments do not reflect a source or use of funds for the utility or an investment in utility plant. If the Commission were to adopt the reasoning offered by ULH&P to exclude the FAS 109 ADIT, then all ADIT would need to be excluded from the determination of rate base. ULH&P has acknowledged that its FAS 109 ADIT were associated with its jurisdictional as well as non-jurisdictional activities.[44] In previous ULH&P cases, the Commission has determined that ratepayers benefit from ADIT debits since at the time the debit was recorded book income tax expense was lower than the actual liability. Ratepayers also

[42] ULH&P s Response to the AG s First Data Request dated July 10, 2001, Item 3.

[43] T.E., Volume I, November 28, 2001, at 123-124. ULH&P stated that Indiana and Ohio do not include ADIT associated with FAS 109 in the determination of rates and rate base. However, no evidence has been present in this case to support this statement.

[44] T.E., Volume I, November 28, 2001, at 122-123.

benefit from ADIT credits as the timing differences that produced the ADIT credits reverse.[45] In Louisville Gas and Electric Company s (LG&E) last gas rate case, the Commission agreed with LG&E and the AG and included the FAS 109 ADIT in the determination of the jurisdictional rate base ratio and the jurisdictional gas rate base.[46] In this proceeding, no evidence has been presented to persuade the Commission that the jurisdictional portion of ULH&P s FAS 109 ADIT should not be treated as other ADIT when determining the jurisdictional rate base ratio and jurisdictional gas rate base. Therefore, the Commission has included the FAS 109 ADIT balance in the total ADIT used to determine rate base.

Cash Working Capital Allowance. ULH&P and the AG determine the cash working capital allowance using the 45 day or 1/8th formula methodology, reflecting the impacts of adjustments each proposed to gas operation and maintenance expenses. For purposes of determining the jurisdictional rate base ratio, the Commission has used the level of gas and total company operation and maintenance expenses reported at test-year end, before any rate-making adjustments.

The AG argues that expenses recorded in Account No. 807 Gas Purchased Expenses should be excluded from the total operation and maintenance expense level used to determine the cash working capital allowance.[47] The AG contends such an adjustment is consistent with the approach used by the Commission in Case No. 2000-

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[45] See Case No. 90-041, October 2, 1990 Order, at 12; Case No. 91-370, May 5, 1992 Order, at 8; and Case No. 92-346, July 23, 1993 Order, at 8.

[46] See Case No. 2000-080, September 27, 2000 Order, at 21, footnotes 55 and 56, and Appendix C.

[47] Henkes Direct Testimony, Schedule RJH-5.

080.[48] ULH&P argues against the AG s proposal, contending that the expenses in question consist of office supplies, rents, and labor that relate to the gas supply function. ULH&P reasons that it could not be the Commission s intent to eliminate these legitimate operation and maintenance expenses from the cash working capital allowance calculations.[49]

The Commission is not persuaded by the AG s argument. When calculating the cash working capital allowance, the Commission excludes from the total operation and maintenance expenses for the period those purchased gas costs recovered through the utility s Gas Cost Adjustment (GCA) mechanism. Since the purchased gas costs are already recovered through the GCA, is it not appropriate for the same costs to be included in the cash working capital allowance calculations. The Commission has reviewed ULH&P s GCA and has determined that the expenses recorded in Account No. 807 are not recovered through this mechanism. Thus, these additional gas purchased expenses should not be removed from the level of test-year operation and maintenance expenses used to determine the cash working capital allowance.

Based upon the previous findings, the Commission has determined that ULH&P s jurisdictional rate base ratio is 43.113 percent. The calculation of the test-year-end jurisdictional gas rate base and total company jurisdictional rate base are shown on Appendix B.

[48] T.E., Volume II, November 29, 2001, at 97-100.

[49] ULH&P Brief at 19.

Jurisdictional Gas Rate Base

The Commission has determined ULH&P s jurisdictional gas rate base for rate-making purposes by beginning with the test-year-end jurisdictional gas rate base utilized to determine the jurisdictional rate base ratio. The Commission has incorporated three adjustments for rate-making purposes, all of which have been discussed previously in this Order. As noted later in this Order, the Commission has accepted the proposed reduction of $465,727 to ULH&P s test-year depreciation expense. Consequently, we have reduced the gas accumulated depreciation balance by that amount when determining the jurisdictional gas rate base. We have adjusted the test-year ADIT balance to remove the Unrecovered Purchased Gas Cost ADIT in the amount of $520,795. Finally, the cash working capital allowance included in the Commission s determination of the jurisdictional gas rate base has been adjusted to reflect the accepted pro forma adjustments to operation and maintenance expenses, as discussed later in this Order.

Based upon the previous findings, we have determined ULH&P s jurisdictional gas rate base for rate-making purposes as of September 30, 2000 to be as follows:

Total Plant in Service	$182,860,221
Add:	
Gas Stored Underground	3,849,839
Materials and Supplies	790,615
Prepayments	16,349
Cash Working Capital Allowance	2,025,358
Subtotal	$ 6,682,161
Deduct:	
Accumulated Depreciation	61,614,951
Customer Advances	3,891,599
Accumulated Deferred Income Taxes	15,113,734
Accumulated Deferred Income Taxes FAS 109	6,086,793
Investment Tax Credits (3 percent)	73,859
Subtotal	$ 86,780,936
NET ORIGINAL COST RATE BASE GAS	$102,761,446

CAPITALIZATION

ULH&P originally proposed a jurisdictional gas capitalization of $106,667,470,[50] which was the result of multiplying its total company capitalization of $268,278,344 by its Total Company Ratio of 39.760 percent.[51] During the course of this proceeding, ULH&P acknowledged that it had not calculated its jurisdictional gas capitalization in a manner consistent with the approach found reasonable by the Commission in Case No. 92-346.

In its rebuttal testimony, ULH&P revised its approach to be consistent with the Commission s prior decision, and also proposed to update its capitalization to reflect capital balances as of September 30, 2001, a year later than the test year in this proceeding. Consequently, ULH&P proposes a jurisdictional gas capitalization of

[50] Application Schedule A.

[51] Application Workpaper WPD-2.10b and WPD-2.10c. The jurisdictional rate base ratio shown on WPD-2.10b is 43.416 percent. The use of the Total Company Ratio is not consistent with previous Commission decisions.

$113,008,266, which was the result of multiplying its total company jurisdictional capitalization as of September 30, 2001 of $261,081,507 by its revised jurisdictional rate base ratio of 42.636 percent.[52] ULH&P argues that it is appropriate to use the most recent capital structure that incorporates and reflects the latest known and measurable changes to the test period.[53] ULH&P contends that its test-year-end total company capitalization was understated due to the accounting treatment used to reflect on its books a pending refund associated with its electric operations. It notes that due to a settlement of the issues that gave rise to the pending electric operations refund, the accounting treatment was reversed subsequent to the test year, and total company capitalization was restated to its appropriate level.[54] ULH&P also argues that the Commission has previously permitted updates to the capital structure for rate-making purposes. ULH&P believes its proposal to update the capital structure to September 30, 2001 balances is consistent with the matching principle. ULH&P contends its proposal to use the September 30, 2001 capital structure is fair and reasonable and accomplishes a primary aim of rate-making, that of adopting rates that are reflective of the conditions during which those rates will be charged.[55]

The AG proposes a jurisdictional gas capitalization of $102,921,891, which is the result of multiplying his total company jurisdictional capitalization of $244,514,878 by his

[52] Smith Rebuttal Testimony, Rebuttal PGS-3, page 1 of 2.

[53] Id. at 2.

[54] T.E., Volume I, November 28, 2001, at 137-139.

[55] ULH&P Brief at 25-28.

jurisdictional rate base ratio of 42.092 percent.[56] In response to a data request, the AG acknowledged that his calculation of the jurisdictional gas capitalization was not consistent with the approach the Commission outlined in Case No. 92-346. The AG revised his proposed jurisdictional gas capitalization to $102,865,454, reflecting his understanding of the Commission s approach.[57]

The AG opposes ULH&P s proposal to update the capital structure to the 12 months ending September 30, 2001. The AG argues that it is appropriate to recognize post-test-year changes in cost rates or changes that do not involve a major rate-making component, but that ULH&P s proposal goes beyond what is reasonable.[58] The AG contends that the updated information contained in ULH&P s rebuttal testimony contains mismatches and several items that are unexplained or unsupported. The AG further argues that there has been no opportunity to conduct discovery on the updated information.[59]

In its rebuttal testimony, ULH&P appears to have confused capital structure and capitalization as being one in the same. The capital structure reflects the percentage that each of the components of capitalization represents of the total, and is utilized to determine the weighted average cost of capital. This resulting cost of capital is then applied to the capitalization to determine the reasonable level of net operating income.

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[56] Henkes Direct Testimony, Schedule RJH-3.

[57] AG s Response to the Commission Staff s First Data Request dated October 18, 2001, Item 1.

[58] T.E., Volume II, November 29, 2001, at 91-92.

[59] Id. at 58-60.

ULH&P s proposal to use the September 30, 2001 capitalization violates the concept in rate-making known as the matching principle. The Commission agrees with the AG that ULH&P s proposal to update only its capitalization is inappropriate and unreasonable.

The Commission also is not persuaded by ULH&P s claim that its test-year-end total company capitalization was understated due to the accounting treatment used to reflect a pending electric operations refund. ULH&P did not disclose this situation until the hearing, although it claims the adjustment was made in the spring of 2000.[60] The reversal of this accounting entry was not subsequently disclosed in this record when it became known by ULH&P, although the settlement of this issue occurred in the spring of 2001.[61] As correctly noted by the AG, there is no evidence in the record supporting the claims made by ULH&P and there has been no opportunity for discovery. Finally, the Commission observes that if the refund requirement was associated with ULH&P s electric operations, there should be no impact on its gas operations.

The Commission has determined that ULH&P s jurisdictional gas capitalization, including gas Job Development Investment Tax Credits (JDIC) was $105,849,345. The calculation of this amount is shown on Appendix C. In determining this amount, the Commission utilized the test-year-end balances for debt and equity included in

[60] T.E., Volume I, November 28, 2001, at 138 and 140.

[61] ULH&P was requested to provide any information, when known, which would have a material effect on the net operating income, rate base, or cost of capital which occurred after the test year but was not incorporated in the filed testimony and exhibits. See ULH&P s Response to the Commission Staff s First Data Request dated April 25, 2001, Item 37.

capitalization, which includes a correction for a $1,336,400 understatement of the sale of accounts receivable included as short-term debt. [62]

The Commission has determined the jurisdictional gas rate base for rate-making purposes to be $102,761,446, which is $3,087,899 lower than the Commission-determined jurisdictional gas capitalization. This raises the question of whether ULH&P s gas revenue requirements should be determined using the jurisdictional gas rate base or jurisdictional gas capitalization. Both ULH&P and the AG utilized the jurisdictional gas capitalization, which both had determined was lower than jurisdictional gas rate base. However, the Commission notes that had ULH&P used the correct balance for its sale of accounts receivable and the correct jurisdictional rate base ratio in its application, its jurisdictional gas capitalization would have exceeded its jurisdictional gas rate base.[63] In addition, in its rebuttal testimony, ULH&P s jurisdictional gas capitalization exceeded its jurisdictional rate base.[64] If the AG had determined rate base in a manner consistent with previous Commission decisions and corrected for the error in the sale of accounts receivable, the Commission believes the AG would have achieved similar results.

When determining the valuation of a utility to be used in calculating revenue requirements, the Commission is guided by KRS 278.290(1), which states in part:

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[62] ULH&P s Response to the Commission Staff s Hearing Requests, Item 1.

[63] See Application Workpaper WPD-2.10b and WPD-2.10c. Adding $1,336,400 to total capitalization of $268,278,344 results in a revised total of $269,614,744. Multiplying this revised total by the Jurisdictional Ratio of 43.416 percent results in a jurisdictional gas capitalization of $117,055,937, which is $1,841,284 more than its jurisdictional gas rate base.

[64] See Smith Rebuttal Testimony, Rebuttal PGS-3, pages 1 and 2 of 2.

> In fixing the value of any property under this subsection, the commission shall give due consideration to the history and development of the utility and its property, original cost, cost of reproduction as a going concern, capital structure, and other elements of value recognized by the law of the land for rate-making purposes.

While the Commission has previously found that ULH&P s revenue requirements should be determined using capitalization, we are obligated to consider determining revenue requirements using rate base if evidence is present supporting such a finding. During the review of ULH&P s application and financial information, the Commission has noted that gas utility plant balances and accumulated depreciation balances, before the removal of non-jurisdictional items, cannot be matched to corresponding accounts in ULH&P s trial balance.[65] The Commission also notes that ULH&P does not routinely prepare separate balance sheets for its gas and electric operations.[66] The Commission does not believe the differences noted in plant and accumulated depreciation would have a significant impact on the determination of the jurisdictional rate base ratio. However, this situation, along with the fact that ULH&P does not prepare separate balance sheets, gives the Commission concern as to how well the rate base reflects the investment in ULH&P.

Based on the circumstances in this case, the Commission finds that ULH&P s gas revenue requirement should be determined by applying the weighted average cost of capital to the jurisdictional gas capitalization. In this instance, the Commission believes the capitalization of ULH&P is a better measure of the true cost of providing

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[65] See Application Schedules B-2.1 and B-3 and ULH&P s Response to the Commission Staff s First Data Request dated April 25, 2001, Item 9(a), page 9 of 16.

[66] ULH&P s Response to the Commission Staff s Third Data Request dated September 4, 2001, Item 11(a).

service since it is the cost of debt and equity that is reflected in the financial statements of ULH&P.

REVENUES AND EXPENSES

For the test period, ULH&P reported actual net operating income from gas operations of $8,480,044.[67] ULH&P proposes a series of adjustments to revenues and expenses to reflect more current and anticipated operating conditions, which results in an adjusted net operating income from gas operations of $6,112,728.[68] The AG proposes his own series of revenue and expense adjustments to arrive at his adjusted net operating income from ULH&P s gas operations of $7,517,290.[69] The Commission finds that 11 of the adjustments proposed by ULH&P and accepted by the AG are reasonable and will be accepted:

- employee wage increase;
- employee heath care costs;
- removal of non-jurisdictional regulatory commission expenses;
- depreciation expense;[70]
- payroll taxes;
- removal of Edison Electric Institute (EEI) dues charged to gas operations;

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[67] Application Schedule C-2.

[68] Id. Subsequently, ULH&P revised its net operating income amount in conjunction with its proposal to update its capital structure to September 30, 2001. The revised net operating income was $6,108,756. See Smith Rebuttal Testimony, Rebuttal PGS-1, page 3 of 8.

[69] Henkes Direct Testimony, Schedule RJH-8.

[70] Includes corresponding adjustment to state and federal deferred income taxes to reflect annualization of depreciation expense.

- removal of prior year state and federal tax adjustments;
- correction of state and federal income taxes;
- removal of expenses associated with the Florence office building;
- removal of revenues and expenses related to facilities devoted to other than ULH&P customers; and
- removal of revenues and expenses associated with ULH&P s demand side management (DSM) rider mechanism.[71]

The Commission also finds the new depreciation study filed by ULH&P in this case to be reasonable, and those depreciation and amortization rates should be approved for accounting and rate-making purposes as of the date of this Order. The Commission makes the following modifications to the remaining proposed adjustments:

Revenue Normalization

ULH&P s normalized revenues reflect several adjustments to test-year actual revenues. The adjustments impact base rate revenues, other revenues, and gas cost revenues. The overall impact of all of ULH&P s proposed adjustments is to increase test-year revenues by $9,878,068.[72] The following paragraphs identify all adjustments that have been modified, as well as new adjustments included by the Commission.

Revenue Normalization Base and Other. ULH&P proposes to normalize base rate and other revenues for the test year to reflect current rates and customer levels, normal weather conditions (temperatures), and the elimination of various non-

[71] While the Commission is accepting the adjustments for facilities devoted to other than ULH&P customers and the DSM rider mechanism, we are adjusting the PSC Assessment component of the adjustment, as described later in this Order.

[72] Application Schedule C-2. ULH&P included in this adjustment its determination of the AFUDC Offset. This adjustment will be discussed separately later in this Order.

jurisdictional or non-base rate revenue items. ULH&P s proposed adjustments result in combined adjusted base and other revenues of $33,682,562. Most of its proposed adjustments were agreed to by the AG and are found to be acceptable by the Commission. However, there were two specific areas on which the AG disagreed and proposed alternative adjustments.

Customer Levels Customer Usage. ULH&P recognized reductions in revenue due to reduced gas usage by two large customers, Johns Manville and Newport Steel. These reductions, which occurred in April 2000 for Johns Manville and March 2001 for Newport Steel, were known and measurable when ULH&P filed its application, and result in a revenue decrease of $583,000.

The AG agrees with this adjustment, but proposes an additional adjustment to increase revenues by $33,555 to recognize the addition of two new customers. These customer additions occurred in May 2001 and August 2001, both more than 6 months beyond the end of the test year. Based on both the magnitude of the revenue adjustments and when the changes in the customers gas usage occurred, the Commission will accept ULH&P s adjustment to decrease revenues by $583,000. For the same reasons, we find that the increase of $33,555 proposed by the AG should be rejected.

Weather Normalization. ULH&P proposes to adjust gas sales for the test period using National Oceanic and Atmospheric Administration (NOAA) normal heating degree days derived from actual weather experienced over the 10-year period from 1990 through 1999. The test period was warmer than normal, meaning sales were less-than-normal. Adjusting to a normal level of sales, based on the 10 years from 1990 through 1999, ULH&P calculates an increase in revenues of $954,220. The AG argues that ULH&P s proposal, based on 10 years of weather data, is not a better predictor of weather conditions and that test-period revenues should be normalized using the 30-year NOAA method traditionally utilized by the Commission in prior ULH&P rate cases.[73] In his prepared testimony, the AG proposed an adjustment to increase revenues by $1,995,540, based on NOAA 30-year average heating degree days from 1961 through 1990. In his brief, the AG noted that a more recent 30-year average period from 1970 through 1999 could be used. Using the more current period, the AG calculated a revised weather normalization adjustment of $1,749,843, a decrease of $245,697 from his original proposal of $1,995,540.

The Commission finds that ULH&P s proposed adjustment is not consistent with the 30-year normal methodology used in previous ULH&P rate cases. There is no evidence that ULH&P s proposed methodology using 10-year NOAA normals is any better predictor of weather conditions than the traditional 30-year method based on NOAA s official published 30-year normals. Although the official NOAA 30-year normals have been used in prior ULH&P cases, the Commission has, on occasion, accepted updated 30-year periods in cases when the official NOAA 30-year normals were several years old at the time of the case.[74] Since that is the situation in this proceeding, we will approve the use of an updated period ending in 1999 that reflects the 30 years 1970-

[73] NOAA official 30-year normals include 30 years ending with the last year of a decade. For any 30-year period, the official normals are typically not published until more than a year after the end of the final year of the period.

[74] Case No. 90-013, Rate Adjustment of Western Kentucky Gas Company, final Order dated September 13, 1990.

1999. The resulting weather normalization adjustment based on this more recent 30-year period is $1,749,843, the amount of the adjustment included in the AG s brief.

One other proposed adjustment requires modification. ULH&P calculated an increase of $117,071 to recognize increased late payment charge revenues related to the remainder of its revenue adjustments, including its proposed adjustment to gas cost revenues. Since some of those adjustments, including the weather normalization adjustment and the adjustment to gas cost revenues, are being increased, the adjustment to late payment charge revenues must be increased accordingly. Based on the overall impact of the different revenue adjustments included herein, the adjustment to late payment charge revenues has been increased by $84,479 to $201,550.

Summary. The Commission modified three of the proposed adjustments by ULH&P[75] to base and other revenues. The combined impact of these modifications results in adjusted base and other revenues of $34,562,664.

Revenue Normalization Gas Cost Revenue

ULH&P s normalized operating revenues of $86,698,001 included gas cost revenues of $53,015,439 based on its test-year-end wholesale gas cost. Based on ULH&P s currently approved GCA the Commission has increased normalized revenues an additional $8,239,566 to $61,255,005.[76] Similarly, the Commission has increased purchased gas expense to a total of $61,255,005 based on ULH&P s current GCA. The gas cost revenue adjustment and other approved revenue adjustments result in

[75] As noted previously, the Commission s decision concerning the AFUDC Offset is discussed later in this Order.

[76] Case No. 92-346-II, final Order dated November 19, 2001.

normalized revenues for rate-making purposes of $95,700,409, exclusive of the AFUDC Offset, discussed later in this Order.

Charitable Contributions, Advertising Expenses, and Miscellaneous Expenses

ULH&P proposes to remove $35,262 for expenses associated with charitable contributions, initiation fees and country club expense, sales expense, community relations expense, advertising expense, and other miscellaneous expense.[77] ULH&P states that these expenses are being eliminated in order to be consistent with previous Commission decisions and, with regard to advertising expenses, to comply with 807 KAR 5:016.

Based on his analysis, the AG accepted the adjustment proposed by ULH&P and proposed the removal of several additional expense items totaling $27,941.[78] Included in the AG s adjustment is the removal of $15,193 in stock option loan expenses. The AG reasons that since these expenses relate to setting up loans for key employees to increase their ownership in Cinergy, this expense should not be borne by ratepayers.[79] The AG s adjustment removes $7,371 related to government affairs expense, which he believes are inappropriate for rate-making purposes.[80] The AG recommends removing the expenses associated with a company picnic, which he contends is consistent with

[77] Application Schedule D-2.2.

[78] Henkes Direct Testimony, Schedule RJH-16. Included in the AG s proposed adjustment is $2,985 related to ULH&P s recalculation of its injuries and damages expense, as requested by the Commission Staff. This portion of the AG s adjustment will be discussed later in this Order.

[79] Id. at 44.

[80] Id. at 45.

previous Commission decisions. The AG s proposed adjustment removes expenses for the Legislative Exchange Council. The AG argues this expense should not be charged to ratepayers, noting that this council provides entities with the opportunity to work closely with state legislators. Finally, the AG removes certain expenses he contends ULH&P agreed should not be included for rate-making purposes.[81]

ULH&P takes issue with the AG s proposal to remove the stock option loan expenses. ULH&P argues that this expense should be included for rate-making purposes because it is a cost of attracting and retaining talented management employees and it encourages the alignment of management interests with that of ULH&P s shareholders and ratepayers.[82]

The Commission is not persuaded by ULH&P s arguments concerning the stock option loan expenses. ULH&P has provided no evidence to support the claim that it must offer the stock option loan program in order to attract and retain talented management employees. Further, we do not agree that such a program will align management interest with that of ULH&P s ratepayers. The encouragement of management employees to own more company stock aligns those employees interests with shareholders only. The Commission consequently agrees with the AG, and finds the stock option loan expenses should not be included for rate-making purposes.

The Commission will accept the proposals as submitted by ULH&P and the AG, with one correction. The AG s adjustment for miscellaneous non-jurisdictional expenses includes a double-count of expenses already removed by ULH&P, which we have

[81] Id. at 44-45.

[82] ULH&P Brief at 39-40.

corrected. In addition, the Commission has identified three additional expenses that should be removed for rate-making purposes. First, ULH&P s gas expenses include $1,377 in expenses associated with a real time pricing billing system, which ULH&P has acknowledged should have been charged to its electric operations.[83] Second, the test year includes $3,179 in expenses associated with the Midwest Energy Association. ULH&P has indicated that this organization does engage in lobbying activities, and many of its activities are similar to the Kentucky and American Gas Associations. Because this organization does engage in lobbying activities, as well as there being an apparent overlap with other associations, the Commission finds this expense should be excluded for rate-making purposes. Finally, the Commission has removed an EEI charge for on-line utility information. Therefore, the Commission has removed expenses totaling $64,380 for rate-making purposes. The details of this adjustment are shown on Appendix D.

The Commission has observed that some of the expenses the AG identified, and ULH&P agreed should be excluded for rate-making purposes, involved expenses applicable to operations in Indiana and Ohio that were assigned to ULH&P and expenses for ULH&P s electric operations that were allocated to gas operations. Both situations imply that ULH&P and Cinergy are not adequately monitoring the operation of their cost allocation processes. When allocating expenses over several operating or business units of a mutli-state corporation, part of the review should be a determination of whether the expense is associated with operations in a particular state. At the ULH&P level, the review process during the allocation of expenses should first

[83] T.E., Volume I, November 28, 2001, at 146.

determine if the expense is specifically for electric or gas operations, before being treated as a common item and allocated to both operations. The Commission advises ULH&P and Cinergy to review their allocation processes and undertake any corrective action that will minimize the occurrence of similar allocation problems in the future.

Rate Case Amortization

ULH&P proposes to increase test-period expenses by $165,000 to reflect the amortization of its estimated rate case expense of $495,000 over a 3-year period.[84] The AG proposes to increase expenses by $48,896, which reflects different amortization periods for specific expenses that comprise his total allowable rate case expense of $263,525.[85] The AG proposes to amortize 50 percent of the expense associated with ULH&P s AMRP study over 10 years. While the AG strongly opposes the AMRP Rider proposal and believes that stockholders would be the primary beneficiaries of the AMRP Rider, the AG is willing to allow a portion of the study expenses associated with the determination of the most appropriate line replacement program to be recovered through rates. The AG proposes to amortize the expense of the depreciation study over 5 years, contending this is an appropriate amortization period. Lastly, the AG proposes that the remaining rate case expenses be amortized over 3 years, consistent with the Commission s previous decisions concerning the amortization of rate case expenses.[86]

[84] Application Schedule F-6.

[85] The AG s total is based on actual rate case expenses incurred through July 31, 2001. See Henkes Direct Testimony, Schedule RJH-11.

[86] Id. at 36-37.

ULH&P opposes several parts of the AG s proposal. ULH&P argues that to exclude 50 percent of the AMRP study expenses is arbitrary, and contends that the expenses were prudently incurred and should be allowed full recovery in a timely manner. ULH&P objects to the proposal to amortize the AMRP study expenses over 10 years and the depreciation study over 5 years. ULH&P claims that the Commission has traditionally allowed the amortization of costs related to expert witness testimony over the period the rates established in the proceeding are expected to be in effect. Finally, ULH&P states that the AG has not used the most recent rate case expense information available, and that the October 2001 expense level of approximately $452,000 confirms the reasonableness of its original estimate of $495,000.[87]

The most recent report of actual rate case expenses provided to the Commission covers expenses through October 2001. That response shows actual rate case expenses to date of $452,098.[88] In previous decisions, the Commission has based its allowed rate case expense amortization on the actual rate case expenses supplied by the utility through periodic updates. ULH&P has offered no evidence to support a deviation from that practice.

The Commission agrees with the AG that the expense of the AMRP study should be amortized over a 10-year period. That study indicates ULH&P should initiate and complete an extensive line replacement program over the next 10 years. The Commission believes it is reasonable to match the recovery of the study expenses over

[87] Smith Rebuttal Testimony at 5-6.

[88] Response to the Commission Staff s First Data Request dated April 25, 2001, Item 48, updated response filed November 21, 2001, page 39 of 56.

the period the actual line replacement program should be in place. However, the Commission does not agree with the AG s proposal to disallow 50 percent of the study expenses. We find it reasonable to allow ULH&P to recover the total actual expense of the study from ratepayers, based on the expense reported through October 2001.

The Commission agrees with ULH&P that the expense of the depreciation study and the remaining rate case expenses should be amortized over a 3-year period. We believe a 3-year amortization period for the depreciation study is reasonable in this case, given the impact the line replacement program could have on future depreciation analysis and the timing of ULH&P s next rate case, which is discussed later in this Order. Therefore, the Commission will include rate case amortization expenses of $75,933 for rate-making purposes.[89]

<u>Overtime Expense</u>

During discovery, ULH&P was asked whether it agreed that in order to determine a reasonable, ongoing level of overtime costs for rate-making purposes, one approach would be to base the ongoing level on the mathematical average of the test year and 4 previous calendar years of overtime expense. ULH&P agreed that such an approach would be reasonable for rate-making purposes.[90] The AG proposes an adjustment to overtime expense, using a historic average ratio approach. The ratio reflects the actual

[89] The actual expense of the AMRP study through October 2001 is $320,428; a 10-year amortization of that amount results in an annual amortization expense of $32,043. The depreciation study expenses and remaining rate case expenses total $131,670; a 3-year amortization of these expenses results in an annual amortization expense of $43,890. The sum of $32,043 and $43,890 is $75,933.

[90] ULH&P s Response to the Commission Staff s Second Data Request dated July 10, 2001, Item 47(c).

overtime expense compared to actual base payroll expenses for the test year and 4 previous calendar years. Using this approach, the AG calculates that ULH&P s test-year overtime expense should be reduced by $28,421.[91] The AG has acknowledged that the use of a mathematical average approach would result in a reduction in expense of $33,995, and states that either his historic average ratio approach or the mathematical average approach results in an appropriate normalized annual overtime expense level.[92]

Since ULH&P has agreed the mathematical average approach is a reasonable method and the AG has not objected to the use of this approach, the Commission finds that the mathematical average approach should be used to determine a reasonable, ongoing level of overtime expense for ULH&P. Therefore, the Commission has reduced ULH&P s operating expenses by $33,995.

Property Tax Expense

ULH&P proposes to reduce its property tax expense by $65,873, which was determined by using the 1999 property tax valuation and average property tax rate.[93] The AG recalculated the adjustment using the 1999 property tax valuation and the 2000 average property tax rate, which results in a reduction of $90,892.[94] During the hearing,

[91] Henkes Direct Testimony at 38-39 and Schedule RJH-12.

[92] AG s Response to the Commission Staff s First Data Request dated October 18, 2001, Item 7.

[93] Application Schedule D-2.8 and Workpaper WPD-2.8a through WPD-2.8c.

[94] Henkes Direct Testimony at 46 and Schedule RJH-17. Starting with ULH&P s normalized property tax level, the AG determined an additional reduction of $25,019 was appropriate. The additional $25,019 plus ULH&P s original reduction of $65,873 equals a total reduction of $90,892.

ULH&P was requested to provide a recalculation of its property tax expense adjustment, using the 2000 property tax valuation and average property tax rate.[95] Using the 2000 information, ULH&P determined its property tax expense reduction should be $111,093.[96] As the use of the 2000 property tax valuation and average property tax rate most closely matches the test year, the Commission finds that the revised expense reduction of $111,093 is the reasonable amount to recognize for rate-making purposes.

Interest Synchronization

ULH&P proposes to increase its interest expense by $2,350,424, which results in a decrease to state and federal income taxes of $948,690.[97] ULH&P s calculation begins with the long-term and short-term debt components of its jurisdictional gas capitalization. It then deducts the debt portion of its CWIP subject to AFUDC. The applicable interest cost rates are multiplied by the net debt components to arrive at ULH&P s normalized gas interest expense. ULH&P determines its increase in its interest expense by comparing its normalized gas interest expense with the sum of its gas interest deducted in the test-year income tax calculation and the gas portion of fees incurred for the sale of accounts receivable. After determining the change in its interest expense, ULH&P calculates the corresponding state and federal income tax effect. When ULH&P filed its rebuttal testimony and proposed to use its updated capital

[95] T.E., Volume I, November 28, 2001, at 134.

[96] ULH&P s Response to the Commission Staff s Hearing Requests, Item 4.

[97] Application Workpaper WPD-2.10a.

structure and capitalization, it revised the reduction to state and federal income taxes to $834,056, but did not provide any workpapers to document the revision.[98]

The AG agrees with the approach and components used by ULH&P to determine this adjustment. The AG has calculated the adjustment using the debt components from his determination of ULH&P s jurisdictional gas capitalization and his recommended interest cost rates. The AG determined that interest expense should be increased by $1,720,734, resulting in a reduction in state and federal income taxes of $707,220.[99] Consistent with his opposition to the use of updated capitalization and capital structure, the AG opposes the revised interest synchronization adjustment ULH&P proposes in its rebuttal testimony.

The approach used by ULH&P to determine its interest synchronization adjustment is the same as the Commission documented in ULH&P s last gas rate case,[100] except in two critical areas. First, ULH&P used its gas interest deducted in the test-year income tax calculation in the proposed adjustment. The Commission has consistently used the test-year actual <u>book</u> interest expense in this calculation, not an interest amount deducted as part of an income tax calculation. Given that the Commission detailed the calculation of this adjustment in ULH&P s last gas rate Order,

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[98] Smith Rebuttal Testimony, Rebuttal PGS-1, page 5 of 8.

[99] Henkes Direct Testimony, Schedule RJH-18. The impact on after-tax operating income shown on Schedule RJH-18 of a negative $241,470 is a reduction to the adjustment determined by ULH&P. Thus, ULH&P s income tax reduction of $948,690 is netted against the AG s impact amount of $241,470. It also should be noted that the AG used an effective state income tax rate of 5.15 percent, while ULH&P calculated its adjustment using the 8.25 percent rate. The income tax rate is discussed later in this Order.

[100] <u>See</u> Case No. 92-346, July 23, 1993 Order, Appendix E.

there should have been no misunderstanding that test-year actual book interest expense was to be utilized. ULH&P has offered no rationale for its modification of the calculation, and the Commission will continue to use the book interest expense.

Second, ULH&P proposes to recognize the gas portion of fees incurred for the sale of accounts receivable in the determination of its interest synchronization adjustment. ULH&P contends that while these fees are not technically an interest expense, they represent a cost of acquiring capital for the ongoing operations of ULH&P. ULH&P also reasons that as the fees are deductible for income tax purposes, ratepayers should receive the tax benefit of that deduction.[101] The AG originally included the accounts receivable fees in the calculation of his interest synchronization. However, in response to a data request, the AG concluded it was not appropriate to include the fees, noting that ULH&P did not include these fees in the calculation of test-year income taxes.[102]

The Commission finds that the fees associated with the sale of accounts receivable should not be included in the determination of the interest synchronization adjustment. ULH&P has acknowledged that the accounts receivable sale fees are included in the short-term debt interest cost rate.[103] If these fees are reflected in the interest cost rate, they should also be reflected in the book interest expense for short-

[101] ULH&P s Response to the Commission Staff s Third Data Request dated September 4, 2001, Item 18(a) and 18(b).

[102] AG s Response to the Commission Staff s First Data Request dated October 18, 2001, Item 9(d).

[103] ULH&P s Response to the AG s Second Data Request dated August 30, 2001, Item 8.

term debt. There would be no need to recognize the fees a second time in the calculation.

The Commission has recalculated the interest synchronization adjustment, reflecting the debt components of ULH&P s jurisdictional gas capitalization and the corresponding interest cost rates found reasonable in this Order. The Commission has determined that ULH&P s interest expense should increase $672,206, resulting in a reduction in state and federal income taxes of $271,319. The calculation of this adjustment is shown on Appendix E.

Injuries and Damages Liability Expenses

ULH&P proposes to reduce injuries and damages liability expenses by $13,833[104] to reflect its 10-year historic average expense. In its calculation, ULH&P uses the calendar year average Consumer Price Index (CPI) for 1990 through 1999 and the September 2000 CPI value for the 9 months of 2000. ULH&P was requested in a data request to recalculate the adjustment, following the approach the Commission outlined in ULH&P s last gas rate case.[105] Based on that approach, ULH&P recalculated the adjustment using the December CPI value for calendar years 1990 through 1999 and the September 2000 CPI for the 9 months ending on September 30, 2000. This recalculation resulted in a reduction to injuries and damages liability expenses of $16,818.[106] ULH&P recognized this revised adjustment in the revised

[104] Application Workpaper WPD-2.12a.

[105] See Case No. 92-346, July 23, 1993 Order, at 34.

[106] ULH&P s Response to the Commission Staff s Second Data Request dated July 10, 2001, Item 33.

revenue requirements it presented in its rebuttal testimony. The AG includes the $16,818 reduction in his proposed revenue requirements determination as well.[107] The Commission has reviewed ULH&P s revised calculation, and finds the reduction of $16,818 to be reasonable.

Limited Early Retirement Program

ULH&P proposes to reduce operating expenses by $326,976 to annualize the gas portion of the expenses related to a Limited Early Retirement Program (LERP) offered to employees during 2000. ULH&P s proposal removes from the test year the gas portion of LERP expenses, recognizes the first year of a 3-year amortization of those expenses, and recognizes a permanent reduction in labor expenses.[108] ULH&P did not include the unamortized portion of the LERP expenses in its rate base calculations. ULH&P proposes a 3-year amortization, claiming the Commission allowed a 3-year amortization of downsizing costs in Case No. 92-346[109] and arguing that the LERP expenses have already reduced the common equity component of its capitalization.[110]

The AG generally agrees with this rate-making proposal, noting that if the annual savings from the LERP are properly quantified and reflected for rate-making purposes, then those savings will flow to ratepayers on a going forward basis. Consequently, it

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[107] Henkes Direct Testimony, Schedule RJH-16.

[108] Smith Direct Testimony at 16-17.

[109] ULH&P s Response to the Commission Staff s Second Data Request dated July 10, 2001, Item 35.

[110] ULH&P Brief at 37.

would be appropriate to give rate recognition to the costs incurred to implement the LERP. The AG proposes a reduction in operating expenses of $518,060.[111] The AG s adjustment recognizes a larger permanent reduction in labor expenses than ULH&P.[112] The AG has also divided the amortization period, proposing to amortize the immediate, one-time cash payments over 3 years, while amortizing the delayed cash payments over 10 years. The AG contends this approach is consistent with the Commission s treatment of the 1992 downsizing costs in Case No. 92-346.[113]

The Commission agrees with the AG and finds that his adjustment should be adopted for rate-making purposes. The AG s amortization proposal is consistent with the treatment authorized by the Commission in Case No. 92-346. The LERP has components similar to those in the 1992 downsizing: immediate cash outlays and outlays over a period of years. Nothing in ULH&P s arguments persuade the Commission that amortizing all the expenses over 3 years is appropriate. Therefore, the Commission will reduce operating expenses by $518,060.[114]

AFUDC Offset

ULH&P proposes to increase its revenues by $117,260 to recognize an offset to its revenue requirements associated with including CWIP subject to AFUDC in rate

[111] Henkes Direct Testimony, Schedule RJH-13.

[112] ULH&P recognized the impact of the larger labor expense reductions in its rebuttal testimony, revising the proposed reduction to $475,655. See Smith Rebuttal Testimony, Rebuttal PGS-1, page 3 of 8.

[113] Henkes Direct Testimony at 41.

[114] Included in the adjustment is $60,264 for the first year of the 3-year amortization of immediate cash payments of $180,792 and $18,174 for the first year of the 10-year amortization of delayed cash payments of $181,737.

base. ULH&P calculated its proposal by multiplying the $1,804,000 balance of CWIP subject to AFUDC by the test-year-end AFUDC rate of 6.50 percent.

As the Commission has stated in two previous ULH&P rate cases, ULH&P s revenue requirements are being determined from capitalization.[115] It is appropriate then to calculate this offset to net operating income using the overall rate of return on capitalization granted in this proceeding, and not the AFUDC rate. Consistent with our past treatment, the Commission has computed an AFUDC offset by multiplying the test-year balance of CWIP subject to AFUDC by the overall rate of return on capitalization. This results in an increase in net operating income of $153,033[116] for rate-making purposes.

Year 2000 Expenses

ULH&P proposes a net increase to its operating expenses of $146,060 to reflect the removal of the test-year expenses associated with its Year 2000 preparedness and the first year of a 3-year amortization of its Year 2000 preparedness expenses incurred from 1997 through 1999.[117] ULH&P argues that this treatment is similar to the rate-making treatment afforded LG&E in its last gas rate case and in a recent Kentucky-

[115] See Case No. 91-370, May 5, 1992 Order, at 44-45 and Case No. 92-346, July 23, 1992 Order, at 37. The Commission notes that ULH&P proposed the use of its AFUDC rate in this calculation in Case No. 91-370, and it was specifically rejected by the Commission.

[116] $1,804,000 times 8.483 percent = $153,033.

[117] Application Schedule D-2.19.

American Water Company (Kentucky-American) rate case.[118] It further believes denying this adjustment would be unjust and punitive. ULH&P states that the 3-year amortization is consistent with the amortization periods approved for LG&E in Case Nos. 2000-080 and 98-426.[119]

The AG opposes the amortization of the Year 2000 preparedness expenses incurred during 1997 through 1999, and proposes to include the test-year level of expense for rate-making purposes. The AG notes that ULH&P expensed, rather than deferred, the amounts as incurred in 1997 through 1999. He argues that to give prospective rate recognition to these previously expensed items is tantamount to retroactive rate-making.[120]

After reviewing the facts in this case and the previous decisions referenced by ULH&P, the Commission finds that ULH&P s proposed adjustment should be rejected and the AG s proposal adopted. As the AG has noted, ULH&P expensed its Year 2000 preparedness expenses during 1997 through 1999, rather than deferring them. This distinguishes ULH&P s case from the case it cited, Case No. 2000-120, as Kentucky-American routinely has deferred such costs for later rate-making treatment, rather than expensing those items as incurred. In Case Nos. 98-426 and 2000-080, the Commission permitted LG&E to amortize over 3 years its <u>test-year expenses</u> associated with Year 2000 preparedness. ULH&P has not demonstrated why it would be

[118] Case No. 2000-120, Application of Kentucky-American Water Company to Increase Its Rates, final Order dated November 27, 2000 and rehearing Order dated May 9, 2001.

[119] ULH&P Brief at 37-38.

[120] Henkes Direct Testimony at 43-44.

appropriate for the Commission in this proceeding to apply a different rate-making treatment to its Year 2000 preparedness expenses than has been used in other cases. Our decision is neither unjust nor punitive. The rejection of ULH&P s attempt to amortize costs already expensed is reasonable, and the Commission is being consistent with previous decisions.

Amortization of Deferred Merger-Related Expenses

ULH&P proposes to increase operating expenses by $967,798 to reflect the first year of a 3-year amortization of deferred expenses relating to the Cinergy merger in 1994. The total unamortized balance of these deferred expenses applicable to ULH&P s gas operations is $2,903,392.[121] ULH&P acknowledges that it did not seek prior Commission approval when it deferred these expenses, but believes that the Commission s approval of the Cinergy merger allowed it to seek recovery of the merger-related costs in its next rate case.[122] ULH&P contends that the merger-related expenses are similar to the 1992 downsizing costs that the Commission approved to be deferred and amortized in its last gas rate case. ULH&P notes that these expenses are the kinds of costs for which the Commission has routinely approved recovery. ULH&P argues its deferral of the merger-related expenses conforms with the requirements of Statement of Financial Accounting Standards No. 71, because the rate actions of this Commission in prior decisions have given reasonable assurance of the existence of the regulatory assets. During the hearing, ULH&P agreed that it would be reasonable to amortize the immediate cash outlay portion of the deferred expenses over 3 years and

[121] Application Schedule D-2.20 and Workpaper WPD-2.20a.

[122] T.E., Volume I, November 28, 2001 at 106-107.

the remainder over 10 years, in a manner similar to the treatment of the 1992 downsizing costs. However, this treatment would only be appropriate if the unamortized balance of the deferred merger-related expenses were included in rate base.[123] In response to arguments in opposition by the AG, ULH&P notes that the Commission s Order in Case No. 94-104 stated that merger savings were expected to be minimal through 1995 but then increase to a peak in 2000. Since the majority of the test year is in 2000, ULH&P reasons that the merger savings are already reflected in the test year, and do not need to be reflected again.[124]

The AG opposes ULH&P s proposal to amortize the deferred merger-related expenses. The AG notes that while ULH&P deferred these expenses that were incurred as far back as December 1992, it has never amortized the deferrals but waited to charge these costs on a going forward basis to ratepayers in its next base rate case. The AG argues that while the merger-related expenses have not been recognized in ULH&P s rates, neither have the savings resulting from the merger-related expenses. Because there has not been this match between expenses and savings, the AG contends that merger-related expense deferral is not similar to the circumstances concerning ULH&P s 1992 downsizing amortization. The AG states that when the Commission allowed the amortization of the 1992 downsizing costs, it was during a rate case where the corresponding savings were also recognized when determining rates. Based on information from ULH&P, the AG has calculated that ULH&P has experienced cumulative savings associated with the merger-related expenses of approximately

[123] ULH&P Brief at 35-36.

[124] Id. at 36.

$17.8 million, which is substantially in excess of the deferred expenses it now seeks to amortize. The AG concludes that as the deferred expenses have been more than offset with associated savings that were never recognized in rates, no amortization of these deferred expenses should be permitted.[125]

The Commission finds the AG s arguments to be persuasive, and we deny ULH&P s proposal to amortize the deferred merger-related expenses. The AG is correct in noting that in ULH&P s last gas rate case, the amortization of the 1992 downsizing costs coincided with the recognition of savings from the downsizing in ULH&P s gas rates. This matching of savings and costs is consistent with previous Commission decisions.[126] ULH&P should have been aware of this matching of savings and costs, for in Case No. 94-104, ULH&P, CG&E, and Cinergy offered the following commitment:

> 7. To make an affirmative showing in any general retail electric, gas, or combined rate proceeding commenced pursuant to KRS 278.190 that the requested rate increase does not reflect merger related costs to the extent that such costs are not offset by merger related benefits.[127]

The Commission s approval of the Cinergy merger was conditioned upon ULH&P, CG&E, and Cinergy submitting written acknowledgement accepting the obligation to be

[125] Henkes Direct Testimony at 17-23.

[126] See Case No. 90-158, Adjustment of Gas and Electric Rates of Louisville Gas and Electric Company, final Order dated December 21, 1990 and rehearing Order dated September 30, 1991. LG&E initiated its downsizing program and incurred related expenses during the test year.

[127] Case No. 94-104, May 13, 1994 Order, at 5.

bound by the commitments offered during the proceeding. All three applicants accepted the obligation.[128]

The booking of ULH&P s merger-related expenses was finalized in 1995 and 1996, depending on the type of expense. ULH&P has stated that the annual savings from the 1994 VERP applicable to its gas operations is approximately $399,000.[129] ULH&P has also estimated that the annual savings in 1996 from the other merger-related activities on a Cinergy-wide basis, exclusive of savings not applicable to gas operations, to be $125,612,000.[130] Using the smallest cost allocation factor utilized to assign merger-related expenses to ULH&P s gas operations, the annual savings applicable to ULH&P s gas operations can be estimated as approximately $2,331,000.[131] Assuming ULH&P s argument that the test year reflects the full impact of the merger-related savings, ULH&P s merger-related savings through 1999 would be approximately $11,319,000,[132] which far exceeds the total gas deferred expenses of

[128] Id. at 22, Finding No. 2. The acknowledgement letters were submitted to the Commission on May 19, 1994.

[129] ULH&P s Response to the AG s First Data Request dated July 10, 2001, Item 62(e).

[130] Id., Item 63. The $125,612,000 reflects the estimated savings for 1996 in the areas of Capital Revenue Requirement, Financing, and the Expense Portion of Other Non-Production O&M Savings and Labor.

[131] Id., Item 61. The smallest cost allocation factor used was 1.856 percent. Multiplying $125,612,000 times 1.856 percent equals $2,331,359.

[132] Multiplying $2,331,000 times 4 years (reflecting the 1996-1999 period) equals $9,324,000. Multiplying $399,000 times 5 years (reflecting the 1995-1999 period) equals $1,995,000. The sum of these amounts is $11,319,000.

$2,903,392. The Commission finds that ULH&P has already recovered the deferred merger-related expense in full.

Since these deferred merger-related expenses have been found to be fully recovered, the Commission also finds that ULH&P should remove these deferred items from its books. Within 30 days of the date of this Order, ULH&P should file with the Commission the accounting entries made to remove the deferred merger-related expenses from its books.

Amortization of 1992 Downsizing Expenses

In Case No. 92-346, ULH&P was authorized to amortize its 1992 downsizing expenses reflecting accrued costs over a 10-year period at an annual rate of $137,480.[133] At the current rate, the remaining 1992 downsizing costs will not be fully amortized until sometime in 2003. The AG proposes that the Commission recalculate this amortization expense, so that the remaining balance will be fully amortized by the expected time ULH&P files for its next rate case. Based on his determination of the remaining balance to be amortized, the AG calculated an annual amortization expense using a 3-year period of $71,912.[134] As the test year already includes an amortization expense of $137,480, to adjust the expense to the AG s proposal requires a reduction of $65,568.

ULH&P opposes the AG s proposal, contending the extension of the recovery an additional 3 years is excessive. ULH&P also disagrees with the AG s assumption that it

[133] Case No. 92-346, July 23, 1993 Order, Appendix D.

[134] Henkes Direct Testimony at 15.

would over-earn because of this expense, noting that as one cost declines another will increase.[135]

The Commission is persuaded by the AG s arguments and finds that the amortization expense for the 1992 downsizing costs should be recalculated. This approach is consistent with our treatment of ULH&P s management audit expenses in Case No. 92-346.[136] The Commission has determined that by the time this Order is issued, the unamortized balance of the 1992 downsizing costs should be $169,909.[137] Amortizing this balance over a 3-year period results in an annual expense of $56,636. As the test year reflects the amortization expense authorized in Case No. 92-346, this adjustment in amortization expense will require a reduction in operating expenses of $80,844.

Account No. 807.1158

ULH&P s test year includes $44,119 in expenses associated with transportation charges billed to end-users. Based on the Commission s decision in ULH&P s previous gas rate case, the AG proposes to remove these expenses because ULH&P did not include the offsetting revenues in its revenue normalization.[138] ULH&P agreed with the

[135] T.E., Volume I, November 28, 2001, at 108-109.

[136] Case No. 92-346, July 23, 1993 Order, at 29.

[137] The unamortized balance as of September 30, 2000 was $353,216. The annual amortization expense of $137,480 stated at a monthly rate is $11,457. The unamortized balance at December 31, 2000 would be $318,846 ($353,216 ($11,457 x 3)). The unamortized balance at December 31, 2001 would be $181,366 ($318,846 $137,480). The unamortized balance at January 31, 2002 would be $169,909 ($181,366 - $11,457).

[138] Henkes Direct Testimony at 43.

AG and reflected this adjustment in its rebuttal testimony.[139] The Commission agrees with the AG and has reduced operating expenses by $44,119.

Annual Incentive Plan

ULH&P s test-year operating expenses include $258,831[140] associated with Cinergy s Annual Incentive Plan (AIP). The AIP is a broad-based, goal-oriented incentive compensation plan applicable to manager level employees and above. For regulated business units like ULH&P, the overall performance goal is divided into three parts: 50 percent corporate goal, 25 percent group specific goals, and 25 percent individual goals. The sole corporate goal is the achieved corporate earnings per share. Failure to achieve the minimum level of the corporate goal means there will be no incentive payment for that goal to AIP participants. Group specific goals are established in cooperation with each participant s immediate supervisor. Group specific and individual goals must be approved in writing by March 31 of a given plan year.[141]

The AIP replaced the Key Employee Annual Incentive Plan (KEAIP) that had been in operation during ULH&P s most recent electric and gas rate cases. In both Case No. 91-370 and 92-346, the Commission excluded for rate-making purposes the expenses associated with KEAIP. We noted that KEAIP focused exclusively on the interests of shareholders, performance targets had been reduced without reasonable

[139] Smith Rebuttal Testimony, Rebuttal PGS-1, page 3 of 8. ULH&P showed this adjustment as an addition to revenues rather than a reduction of expenses.

[140] ULH&P s Response to the Commission Staff s Hearing Requests, Item 10.

[141] Id., Item 8.

explanation, and the compensation and benefits to the plan participants, exclusive of KEAIP, were adequate.[142]

During this proceeding, ULH&P s responses to data requests were unclear as to whether KEAIP was still in operation. The AG proposes that, consistent with previous decisions, the Commission should exclude any test-year KEAIP expenses.[143] However, the AG did not take a position concerning the AIP expense. ULH&P states that the AIP is part of the overall compensation structure that assists it and Cinergy in attracting and retaining talented employees.[144] ULH&P argues that the AIP is consistent with the goal-oriented management practices encouraged by the Commission since the beginning of the management audits in the late 1980s. ULH&P advocates that the expense be included for rate-making purposes.[145]

The Commission has reviewed the AIP materials provided by ULH&P and the overall benefits package provided to employees. While the AIP is not the same plan as KEAIP, the Commission has similar concerns. The corporate goal still places the plan participant s focus on the interests of shareholders by focusing solely on the earnings per share. As we have stated in previous decisions, the interests of both the shareholders and ratepayers should be balanced and protected. ULH&P provided no materials or examples of the group specific or individual goals. Thus, the Commission is unable to evaluate whether we have the same concerns as expressed for the

[142] Case No. 91-370, May 5, 1992 Order at 30-32.

[143] AG Brief at 39.

[144] ULH&P Response to the Commission Staff s Hearing Requests, Item 10.

[145] ULH&P Brief at 38-39.

corporate goal. The overall benefits package provided to employees appears to be adequate, without the AIP, to enable ULH&P to attract and retain talented employees.

Therefore, based on this review, the Commission finds that the AIP expenses should be excluded for rate-making purposes. The operating expenses have been reduced by $258,831.

Uncollectible Accounts Expense

In conjunction with its proposals relating to revenue normalization and the DSM Rider mechanism revenues, ULH&P calculated a corresponding impact on its uncollectible accounts expense. Based on these adjustments, ULH&P determined a net increase in uncollectible accounts expense of $117,652.[146] The Commission has accepted ULH&P s uncollectible accounts expense adjustment relating to the DSM Rider mechanism revenues. The Commission has calculated an adjustment to the uncollectible accounts expense reflecting the revenue normalization decisions discussed previously in this Order. The Commission has included a net increase in uncollectible accounts expense of $214,439.

PSC Assessment

In conjunction with its proposals relating to revenue normalization, DSM Rider mechanism revenues, and revenues associated with facilities devoted to other than ULH&P customers, ULH&P calculated a corresponding impact on its PSC Assessment. Based on these adjustments, ULH&P determined a net increase in its PSC Assessment

[146] Application Schedule D-2.1, page 3 of 4 and Schedule D-2.24, page 2 of 3.

of $21,090.[147] While ULH&P used the PSC Assessment rate in effect at test-year end, it agreed that using the current PSC Assessment rate was consistent with previous Commission decisions.[148] The Commission has calculated the adjustment to the PSC Assessment using the current rate of 1.898. The application of the current rate to the three revenue adjustments results in a net increase in the PSC Assessment of $37,827.

Income Tax Effects

ULH&P proposes to adjust its Kentucky and federal income tax expenses to reflect the use of the effective, rather than stated, Kentucky income tax rate. Using an effective Kentucky income tax rate of 5.15 percent, ULH&P determined that its Kentucky income tax expense should be reduced $217,586, while its federal income tax should be increased by $76,155.[149] The 5.15 percent was based on ULH&P s 1999 Kentucky consolidated income tax return. At the hearing, ULH&P stated that based on its 2000 Kentucky consolidated income tax return, the effective Kentucky income tax rate is 3.03 percent.[150]

The AG supports the use of the effective Kentucky income tax rate in the determination of ULH&P s revenue requirements. The AG argues that to the extent

[147] Application Schedule D-2.1, page 4 of 4; Schedule D-2.24, page 3 of 3; and Schedule D-2.23, page 4 of 5.

[148] ULH&P s Response to the Commission Staff s Second Data Request dated July 10, 2001, Item 25.

[149] Application Schedule D-2.25.

[150] ULH&P s Response to the Commission Staff s Hearing Requests, Item 11.

consolidated income tax filings produce benefits to the regulated utility, those tax benefits should be passed on to ratepayers.[151]

Kentucky income tax law permits corporations such as ULH&P to file consolidated Kentucky corporation income tax returns.[152] Under this approach, Cinergy s net taxable income is apportioned to Kentucky based on a weighted property, payroll, and receipts factor. The effective Kentucky income tax rate is a result of this apportionment of income plus the inclusion of companies that would not have filed a Kentucky return, except for the fact they are a member of Cinergy s consolidated group.[153]

This is the first proceeding in which the Commission has considered the use of the effective, rather than the stated, Kentucky income tax rate. The Commission has some concerns about using this approach, especially since the effective rate changed from 5.15 to 3.03 percent between two tax years. However, the Commission will accept the use of the effective Kentucky income tax rate of 3.03 percent in this proceeding, and will reflect that rate in the determination of ULH&P s revenue requirements. The Commission has recalculated the income tax adjustment reflecting the 3.03 percent rate and the effects of the adjustments discussed in this Order. The Commission has determined that Kentucky income tax expense should be reduced by $594,375, with a

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[151] AG s Response to the Commission Staff s First Data Request dated October 18, 2001, Item 9.

[152] See KRS 141.200 and 103 KAR 16:200.

[153] ULH&P s Response to the Commission Staff s Hearing Requests, Item 11.

corresponding increase in federal income tax expense of $208,031. The calculation of these adjustments is shown on Appendix F.

The Commission is accepting the use of the effective Kentucky income tax rate on a trial basis. In ULH&P s next rate case, it should provide an analysis showing the effective Kentucky income tax rates experienced by ULH&P for the tax years between 2000 and the current tax year applicable to its application. The Commission will review this information at that time to determine whether the use of the effective rate should continue.

Pro Forma Net Operating Income Summary

After consideration of all pro forma adjustments and applicable income taxes, the adjusted net operating income for ULH&P s gas operations is as follows:

Operating Revenues	$95,700,409
Operating Expenses	88,568,054
Net Operating Income before AFUDC Offset	7,132,355
AFUDC Offset to Net Operating Income	153,033
ADJUSTED GAS NET OPERATING INCOME	$ 7,285,388

RATE OF RETURN

Capital Structure

ULH&P proposes an adjusted end-of-test-period capital structure containing 26.99 percent long-term debt, 20.01 percent short-term debt, and 53.00 percent common equity.[154] ULH&P allocated adjustments for its gas JDIC on a pro rata basis to all components of capitalization. In response to data requests, ULH&P acknowledged two errors in the determination of its capitalization and capital structure. First, it

[154] Application Schedule J-1.

incorrectly included investment tax credits in its JDIC balance that were included in the determination of its jurisdictional gas rate base.[155] Second, it used an incorrect balance for its sale of accounts receivable when determining its short-term debt.[156] In its rebuttal testimony, ULH&P proposed to update its capital structure to reflect the 12 months ended September 30, 2001, a full year after the end of the test period.[157] ULH&P s arguments in support of the updated capital structure have been noted previously in this Order.

The AG proposes the same test-year-end capital structure as ULH&P proposes in its application.[158] The AG s capital structure also reflects the use of the incorrect balance for the sale of accounts receivable in short-term debt. As noted previously in this Order, the AG opposes the use of an updated capital structure in the determination of ULH&P s revenue requirements.

In previous cases, the Commission has recognized the impact on the capital structure of significant post-test-year issues of debt or equity, but has not adjusted the total capitalization from the test-year-end balance.[159] In this proceeding, ULH&P has

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[155] ULH&P s Response to the AG s First Data Request dated July 10, 2001, Item 4.

[156] ULH&P s Response to the Commission Staff s Hearing Requests, Item 1.

[157] ULH&P s updated capital structure contains 26.00 percent long-term debt, 15.30 percent short-term debt, and 58.70 percent common equity. See Smith Rebuttal Testimony, Rebuttal PGS-2, page 1 of 3.

[158] Henkes Direct Testimony, Schedule RJH-2.

[159] See Case No. 90-041, October 2, 1990 Order, at 37. The Commission notes that the citation in ULH&P s Brief at 25 concerning the decision in Case No. 92-346 relates to the adjustments to capitalization proposed by ULH&P, not the Commission s decision on the reasonableness of those proposed adjustments.

failed to identify and document a significant post-test-year adjustment that should be recognized in its capital structure. Consequently, the capital structure for ULH&P will be based on end-of-test-period.[160]

As shown on Appendix C, the Commission finds ULH&P s gas capital structure is as follows:

	Percent
Long-Term Debt	26.857
Short-Term Debt	20.415
Common Equity	52.728
Total Gas Capital Structure	100.000

Cost of Debt

ULH&P proposes a cost of long-term debt of 7.946 percent and a cost of short-term debt of 6.795 percent.[161] In its rebuttal testimony, ULH&P updated the cost of debt rates as of September 30, 2001. ULH&P states that its updated cost of long-term debt is 7.843 percent and the updated cost of short-term debt is 3.545 percent.[162]

The AG uses the same cost of long-term debt as proposed by ULH&P. The AG initially used the cost of short-term debt as of June 30, 2001, which is 4.457 percent.[163]

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[160] As discussed previously in the Order, the Commission has rejected the use of the updated total company jurisdictional capitalization as of September 30, 2001.

[161] Application Schedule J-2 (short-term debt) and Schedule J-3 (long-term debt).

[162] Smith Rebuttal Testimony, Rebuttal PGS-2, page 2 of 3 (short-term debt) and page 3of 3 (long-term debt).

[163] ULH&P s Response to the AG s First Data Request dated July 10, 2001, Item 91. While the AG s rate of return witness proposed the use of 4.457 percent, his revenue requirements witness used 4.34 percent, which is the interest rate on the sale of accounts receivable only. See Henkes Direct Testimony, Schedule RJH-2.

The AG subsequently agreed with ULH&P that the cost of short-term debt should be 3.545 percent.[164]

The Commission finds it appropriate to recognize the debt cost rates as of September 30, 2001 when determining the overall cost of capital for ULH&P s gas operations. The recognition of the updated debt cost rates constitutes a known and measurable adjustment and is more representative of the period the rates established in this Order will be in effect as compared to the test-period-end debt cost rates. However, these debt cost rates will be applied to the test-period-end capital structure. Therefore, the Commission finds the cost of long-term debt to be 7.296 percent[165] and the cost of short-term debt to be 3.545 percent.

Return on Equity

ULH&P estimated its required return on equity (ROE) using three methods: the Capital Asset Pricing Model (CAPM), the Risk Premium and the Discounted Cash Flow (DCF).[166] Using the results of the three methods, ULH&P determined its ROE to be 12.0 percent, including a flotation adjustment of 30 basis points. ULH&P stated that the AMRP Rider would lower its business risk but that this lower risk was offset by the

[164] AG Brief at 42.

[165] ULH&P s Response to the Commission Staff s Hearing Requests, Item 2, page 2 of 2. The cost of long-term debt presented in ULH&P s rebuttal testimony used the carrying value of the long-term debt and unamortized balance for loss on reacquired debt. The cost of long-term debt included in the Hearing Request response used the outstanding balance of debt. The Commission believes the 7.296 percent debt cost rate reflects the appropriate treatment of the unamortized loss of reacquired debt.

[166] Morin Direct Testimony at 12.

increased business risk associated with the flooding incident that occurred in the city of Newport in October of 2000.[167]

As its stock is not publicly traded, analyzing ULH&P s ROE based on the CAPM and DCF methods requires the use of proxy companies. ULH&P used 14 natural gas distribution utilities and 15 electric generation divestiture utilities covered by The Value Line Investment Survey as proxies in its CAPM and DCF analyses. ULH&P stated that the reason for performing the analysis on an industry composite rather than on individual company data is to mitigate the possible vagaries of individual company results. ULH&P argues that the 15 electric generation divestiture utilities are similar to gas distribution companies because they offer the distribution of energy services at regulated rates in a cyclical and weather sensitive market, are capital intensive networks with similar physical characteristics, and are subject to rate of return regulation.

ULH&P advocated adjusting its ROE award by 30 basis points for flotation costs to recoup the cost of equity issued in prior periods. ULH&P argued that there are two components to flotation costs, a direct component related to the compensation to the underwriter and an indirect component related to the downward pressure on the stock price as a result of the increased supply of stock from a new issue. ULH&P stated that it required the continued collection of flotation costs even if there are no further issues in the future in order to allow it to recover such costs over the life of the funds.[168]

[167] Id. at 35.

[168] Morin Direct Testimony at 31-34.

The AG also estimated ULH&P s ROE using the CAPM, DCF and Risk Premium methodologies. In his analysis, the AG used stock price data from five gas distribution companies selected on the basis of their similarity to ULH&P in leverage ratios, sales to total assets ratios, and the percentage change in revenues. The AG used the data from these companies rather than data for Cinergy because Cinergy receives much of its revenues, 64 percent in the year 2000, from electric operations, which is not representative of ULH&P s gas operations. Taking the results of these methods, the AG estimated ULH&P s ROE to be between 9.75 percent and 10.75 percent, with no flotation cost adjustment.[169] The AG agreed that the AMRP Rider would lower ULH&P s risk. The AG later corrected the results of his risk premium analysis, revising his average result to reflect an ROE of 10.12 percent to 10.98 percent.

The AG stated three reasons for his opposition to adjusting the ROE award for flotation costs: (1) ULH&P has not received any equity capital from CG&E since at least 1997; (2) ULH&P has paid CG&E $37.8 million in dividends since 1997; and (3) only a portion of the source of the funds for the equity investment from CG&E would have a cost.[170] The AG further argued that flotation costs are historical costs and the cost of equity rate is a measure of a future return.[171] The AG criticized ULH&P s proxy group of comparison companies, contending that one of the assumptions behind using a group of companies as proxies is that the companies should resemble as nearly as possible the company in question.

[169] Weaver Direct Testimony at 43.

[170] Weaver Direct Testimony at 38.

[171] Id. at 37-39.

ULH&P, in its rebuttal testimony, criticized the AG s sample size, methodology and inputs used to derive his recommended ROE. ULH&P stated that the AG had understated the ROE range by not including 30 basis points for flotation costs and also argued that the AG s recommendation was not compatible with currently allowed returns in the natural gas utility industry.[172] ULH&P provided a revised ROE recommendation in its rebuttal testimony, recommending a range of 11.0 percent to 11.5 percent, citing subsequent changes in long-term interest rates, stock prices and capital structure as a result of the events of September 11, 2001 as the reason for the revision.[173]

The Commission finds that it is not appropriate to include electric companies in the proxy group since this case pertains to only the gas operations of ULH&P. The Commission also finds that it agrees with the AG regarding the inclusion of flotation costs in the awarded ROE, and that such a finding is consistent with past Commission practice. The Commission agrees in part with ULH&P s critique of the AG s cost of equity estimations. The revisions presented in the Errata Sheet on November 1, 2001 indicate that the AG should have revised his overall recommended ROE. A further consideration is that the Commission is approving a modified version of ULH&P s AMRP Rider. Both ULH&P and the AG agree that the rider will reduce ULH&P s level of risk. The Commission believes the rider will work to stabilize revenues over time and that it should decrease the risk to shareholders. Using the revised ROE ranges of ULH&P and the AG, considering the full range of the analyses, and weighing all the

[172] Morin Rebuttal Testimony at 4.

[173] Id. at 25-26.

relevant evidence in the record, the Commission finds that ULH&P s ROE falls in a range of 10.75 percent to 11.25 percent with a midpoint of 11.00 percent.

Rate of Return Summary

Applying the rates of 7.296 percent for long-term debt, 3.545 percent for short-term debt, and 11.000 percent for common equity to the capital structure produces an overall cost of capital of 8.483 percent, which we find to be fair, just, and reasonable. The cost of capital produces a rate of return on ULH&P s jurisdictional gas rate base of 8.738 percent, which the Commission finds is fair, just, and reasonable.

REVENUE REQUIREMENTS

The Commission has determined, based upon a jurisdictional gas capitalization of $105,849,345 and an overall cost of capital of 8.483 percent, that the net operating income found reasonable for ULH&P s gas operations is $8,979,200. ULH&P s pro forma net operating income for the test period is $7,285,388. Thus, ULH&P needs additional annual operating income of $1,693,812. After the provision for uncollectible accounts, the PSC Assessment, and state and federal taxes, there is a revenue deficiency of $2,721,336, which is the amount of additional revenue granted herein. The net operating income found reasonable for ULH&P s gas operations will allow it the opportunity to pay its operating expenses and fixed costs and have a reasonable amount for equity growth.

The calculation of the overall revenue deficiency is as follows:

Net Operating Income Found Reasonable	$ 8,979,200
Pro Forma Net Operating Income	7,285,388
Net Operating Income Deficiency	1,693,812
Gross Up Revenue Factor[174]	1.6066340
Overall Revenue Deficiency	$ 2,721,336

The additional revenue granted will provide a rate of return on the jurisdictional gas rate base of 8.738 percent and an overall return on jurisdictional gas capitalization of 8.483 percent. The $2,721,336 increase represents an increase of 2.76 percent over the normalized gross operating revenues.[175]

The rates and charges in Appendix A are designed to produce gross operating revenues, based on the adjusted test year, of $97,545,026. The gas operating revenues reflect the most recent gas cost adjustment approved in Case No. 92-346-II.

PRICING AND TARIFF ISSUES

Cost of Service and Revenue Allocation

ULH&P submitted a fully allocated class cost-of-service study for the test period using a zero intercept methodology.[176] ULH&P states that it used its cost-of-service study as a guide in allocating the proposed revenues among its various rate classes.

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[174] The gross up revenue factor recognizes the impact the overall revenue deficiency will have on the uncollectible accounts, the PSC Assessment, state income taxes, and federal taxes. The Commission s calculation of the gross up factor follows the same approach as ULH&P provided in Application Schedule H. The Commission used the same rates as ULH&P did, with the exception that the current PSC Assessment rate of 1.898 and the 2000 effective Kentucky income tax rate of 3.03 percent were used.

[175] The normalized operating revenues reflect the impact of ULH&P s most recent gas cost adjustment.

[176] Ochsner Direct Testimony at 5.

The AG did not file an alternative cost-of-service study or take issue with ULH&P s cost-of-service study. The Commission accepts ULH&P s cost-of-service study as filed for the purpose of using it as a guide in allocating the revenue increase awarded herein among the rate classes. Using ULH&P s cost-of-service study as a guide in allocating the revenue increase awarded herein following results in increases of 4.14 and 1.11 percent, respectively, for the Residential Service (RS) and General Service (GS) rate classes and decreases of 11.99 and 2.79 percent, respectively, for the Firm Transportation-Large (FT-L) and Interruptible Transportation (IT) rate classes.

Rate Design

ULH&P proposes to increase the monthly customer charge for the RS class from $6.29 to $10.30. ULH&P calculated a monthly charge required for full recovery of residential class customer-related costs in excess of $18.00. ULH&P proposes to increase the customer charge by approximately one-third of the difference between the current charge and the calculated charge of $18.00. Based on a similar calculation for the GS class, ULH&P proposes to increase the monthly customer charge for that class from $12.70 to $18.00. It also proposes increasing the customer charges for both Rate FT-L and Rate IT from $250.00 to $330.00.

The Commission agrees that ULH&P s rate design should change to more closely reflect the distinction between fixed customer costs and variable commodity-related costs. However, although the AG voiced no objections to the proposed rate design, the Commission finds, based on the magnitude of the increase awarded herein, and consistent with our long-standing commitment to the principles of gradualism and rate continuity, that a smaller increase in the customer charges for Rate RS and GS should be approved. Accordingly, we will approve customer charges of $8.30 for Rate RS and $15.25 for Rate GS, which reflect increases equal to approximately one-half of what had been proposed. The remainder of the revenue increase allocated to the RS and GS classes will be recovered through their respective commodity charges. The increased customer charges for Rate FT-L and Rate IT are approved as proposed with their commodity charges being slightly reduced to produce overall decreases for those rate classes, consistent with the cost-of-service results.

The Commission has determined that residential customers using an average of 7.5 Mcf will see an increase of $2.75 in their monthly bills, an increase of 4.2 percent.

<u>Tariff Additions and Revisions</u>

ULH&P proposes revising Rate IT - Interruptible Transportation; Rate FT - Firm Transportation; Rider X - Main Extension Policy; and canceling Rate SS - Standby Service.

ULH&P proposes the following new tariffs:

- Rate AMRP - Accelerated Main Replacement Program Rider applicable to all sales and transportation customers as either a monthly charge or commodity delivery charge
- Rate AS - Aggregation Service applicable to large volume interruptible customers
- Rate DGS - Distributed Generation Service applicable to gas delivery facilities required to service distributed generation facilities
- Rate FRAS - Firm Requirements Aggregation Service applicable to FT-L customers as a pooling service

- Rate GCAT - Gas Cost Adjustment Transition Rider applicable to customers who switch from firm service under Rate GS to transportation service under Rate FT-L
- Rate GTS - Gas Trading Service applicable to FRAS and AS pool customers to trade daily gas supplies
- Rate IMBS - Interruptible Monthly Balancing Service applicable to FRAS and AS customers
- Rate SSIT - Spark Spread Interruptible Transportation applicable to commercial gas fired electric generators where gas is the primary fuel source

The Commission addresses the AMRP Rider below. The Commission will accept and approve the other revisions, cancellations, and new tariffs as proposed by ULH&P.

AMRP Rider

ULH&P s distribution system contains approximately 1,000 miles of distribution mains, 150 miles of which are cast iron and bare steel that date back to 1887 and 1906 respectively.[177] ULH&P asserts that cast iron and bare steel mains are more prone to leaks than coated steel or polyethylene, which may lead to higher operating and maintenance expenses, greater line losses and greater safety and reliability risks.[178] ULH&P states that it has not kept pace with the national average on its replacement of its cast iron and bare steel mains. Therefore, it has begun an AMRP pursuant to which

[177] Torpis Direct Testimony at 8.

[178] Id. at 6.

it plans to replace all its cast iron and bare steel mains within 10 years.[179] ULH&P cites safety and reliability as the major reasons for its decision to accelerate its mains replacement. ULH&P projects that the capital expenditures required for this program will double its current investment in plant and that such an investment will have a substantial impact on its earnings.[180]

In order to alleviate this impact, ULH&P proposes a tracking mechanism, the AMRP Rider, that would permit it to recover its investment costs on a more current basis than that which traditional rate-making permits. ULH&P contends that if the rider is not approved, it will be forced to file several rate cases over the next 10 years in order to recover the costs of this program.[181] ULH&P s proposed methodology computes the revenue requirement effect of both the return on and recovery of the net change in its plant investment attributable to the AMRP. This calculation is done on an annual basis and uses traditional rate-making theory and financial data to be approved in this proceeding. The revenue requirement calculation will also recognize the net reduction in maintenance costs due to the AMRP. ULH&P proposes to file the AMRP Rider annually, on or about the last day of February, to be effective April 1. To address regulatory lag inherent in its proposed AMRP Rider, ULH&P proposes that it be permitted to defer depreciation and continue accruing AFUDC on replacements from the time those replacements are placed into service until such time as recovery begins

[179] ULH&P engaged Stone & Webster in late 2000 to perform an independent review of its distribution system and its cast iron and bare steel replacement program. Torpis Direct Testimony at 7.

[180] ULH&P Brief at 5.

[181] Randolph Direct Testimony at 15.

through the AMRP Rider. ULH&P proposes that the AMRP Rider remain in effect for 10 years. ULH&P also proposes to include the AMRP Rider as part of the customer charge levied on residential and commercial customers bills, while transportation and industrial customers would pay the AMRP Rider as part of a volumetric charge.

The AG objects to the proposed rider on several grounds and contends that the Commission should deny it. The AG argues that ULH&P is seeking approval of a mere concept and therefore has failed to present the Commission with adequate evidence upon which it may render findings of fact and conclusions of law.[182] He asserts that if the Commission does in fact approve ULH&P s proposal, its decision will constitute a major policy change that must be accomplished through the promulgation of a regulation pursuant to KRS Chapter 13A and not through an Order.[183] The Commission does not find the AG s arguments persuasive. KRS Chapter 13A.100 provides:

> [a]ny administrative body which is empowered to promulgate administrative regulations shall, by administrative regulation prescribe . . . (1) Each statement of general applicability, policy, procedure, memorandum, or other form of action that implements; interprets; prescribes law or policy; describes the organization, procedure, or practice requirements of any administrative body; or affects private rights or procedures available to the public; . . . .

The Commission finds that no general policy is implicated here, and that there has been sufficient information provided to enable it to render a decision on the AMRP Rider in this case. The decision reached by the Commission in this case is, and in all future cases will be, based on the specifics of the case before it. This decision is not, and shall not be construed as, a Commission policy nor a statement of general

[182] AG Brief at 3.

[183] Id. at 16-18.

applicability. Therefore, the Commission finds that no administrative regulation is necessary.

Other objections of the AG are based upon his having mistaken directive statutes for enabling statutes. For example, the AG asserts that the future test-year filing investigated by the Commission in Administrative Case No. 331,[184] a method later approved by the General Assembly, directly addresses the type of regulatory lag ULH&P claims makes the tracker necessary. He contends that before ULH&P may seek the relief proposed, it must avail itself of all regulatory opportunities available to it, including that of a future test-year filing pursuant to KRS 278.192. He asserts that the Commission has refused in the past to allow the type of relief ULH&P proposes, that it has in the past clearly demonstrated its unwillingness to engage in single issue rate-making and that it should abide by its own precedent and deny ULH&P s request. The Commission agrees that in an application for a general increase in rates the use of a future test year may help alleviate regulatory lag, but disagrees that the use of a future test year is the only method that may be used to address the problem. The Commission also disagrees that a utility must first use a future test year or demonstrate its ineffectiveness before it may seek approval of any other method. KRS 278.192 states in part::

> For the purpose of justifying the reasonableness of a proposed general increase in rate, the commission shall **allow** a utility to utilize either an historical test period. . .or a forward-looking test period . . . . (Emphasis added)

[184] Administrative Case No. 331, An Investigation of Appropriate Guidelines for Filing Forecasted Test Period.

KRS 278.192(1). The statute permits the utility to file a future test period case. It does not prohibit other alternatives. It does not state that the Commission <u>shall</u> require a utility to utilize either one method or the other; nor does it state that a utility <u>shall</u> prove that both of these opportunities are ineffective before it may seek other relief. Had the General Assembly intended such a result, it could have expressly stated that intent.

The AG also contends that, prior to 1992, KRS Chapter 278 required only that the Commission set fair, just and reasonable rates. He contends that the enactment in 1992 of the future test-year statute and the environmental surcharge statute clearly indicate that, absent specific legislative authority, the Commission does not have the authority to approve ULH&P s proposal. He states that had the Commission, under its broad authority to set fair, just and reasonable rates, had the authority to participate in single issue rate-making or consider capital additions outside a general rate case, it would not have been necessary for the General Assembly to enact the statutes permitting a future test-year filing (KRS 278.192) or the environmental surcharge (KRS 278.183). The Commission disagrees. It believes the General Assembly intended prior to 1992 and after 1992 for the Commission to have broad implied and discretionary authority to establish fair, just and reasonable rates. The Commission agrees with the AG that the enactment of KRS 278.183 has changed its authority, but disagrees with the AG on what that change represents. KRS 278.183 states in part:

> Notwithstanding any other provision of this chapter, effective January 1, 1993, a utility <u>**shall be entitled**</u> to the current recovery of its cost of complying with the Federal Clean Air Act. . .These costs <u>**shall include**</u> a reasonable return on construction and other capital expenditures and reasonable operating expenses. . . . (Emphasis added)

Contrary to what the AG suggests, this statute was not enacted to grant the Commission authority it did not already have. Instead, this statute was enacted by the legislature to limit the Commission s otherwise broad, discretionary authority. The legislature intended for environmental compliance costs to be recovered on a current basis and intended to, and did, by the enactment of KRS 278.183, remove the Commission s authority to deny such recovery. In addition, the legislature mandated the specific costs that are to be included. In other words, rather than authorizing the Commission to establish a surcharge, the General Assembly mandated that it establish a surcharge under certain conditions.

The AG has made a similar argument with regard to the General Assembly s enactment of the KRS 278.285, the demand-side management statute.[185] The Commission, again, finds this statute to be directive rather than authorizing. The General Assembly specifically set forth factors that the Commission is to consider when determining the reasonableness of demand-side management plans that are proposed. In addition, the mandatory language used by the General Assembly in KRS 278.285(3) once again removes Commission discretion. It specifically directs the Commission on how to assign the costs of the programs.

In addition to finding that it has the authority under its general powers to establish fair, just and reasonable rates, the Commission finds that it has the authority to review and approve the AMRP Rider pursuant to KRS 278.290. KRS 278.290 authorizes the Commission, on its on motion, upon complaint or upon application, after hearing, to ascertain the value or make reevaluations from time to time of all new construction,

[185] AG s Brief at 23.

extensions and additions to the property of a utility if the valuation or revaluation is necessary or advisable in order to determine the reasonableness of any rate. That is precisely what the tracker is to do. This is precisely what the Commission will be asked to do when ULH&P files its annual AMRP Rider application.

However, the Commission has reviewed the specific AMRP Rider mechanism as proposed by ULH&P and finds that components of it are neither reasonable nor acceptable. The continued accrual of AFUDC and the deferral of depreciation on utility plant already in service is inappropriate and unduly compensates ULH&P. By making such a proposal, ULH&P goes beyond attempting simply to eliminate regulatory lag. While the Commission is willing to consider alternative cost recovery approaches to address unique situations like the one presented by the AMRP, it will not consider a methodology that allows a utility to earn a return on or recovery of amounts greater than the true investment in plant in service. The Commission notes that in ULH&P s rebuttal testimony it introduces for the first time the inclusion of property taxes as a cost to be recovered.[186] The Commission believes that the net changes in this expense, especially in the early years of the AMRP, will be immaterial and difficult to identify.

ULH&P has proposed that the rate of return applied to its net investment in replacement lines be grossed up for uncollectible accounts, the PSC Assessment, state income taxes, and federal income taxes. The Commission does not believe it is appropriate to include a gross up for uncollectible accounts and the PSC Assessment in the AMRP Rider. The Commission notes that in the environmental surcharge mechanisms its has approved, the gross up factor has only included state and federal

[186] Smith Rebuttal Testimony, Rebuttal PGS-6, page 1 of 3.

income taxes. There is no requirement that the gross up factor used for the AMRP Rider must match exactly the gross up factor used to determine ULH&P s revenue increase in this base rate proceeding.

The Commission finds it unworkable to review the AMRP Rider within a 30-day processing time as originally proposed by ULH&P. ULH&P has indicated that a 60-day period might be acceptable. The Commission believes it will need at a minimum a 60-day review period, and will need to hold a hearing for each annual revision of the AMRP Rider.

The Commission does not find it appropriate to include the AMRP Rider within existing customer charges or volumetric charges on the applicable customers bills. ULH&P s customers are entitled to know how much this significant line replacement program is impacting their natural gas bills. Separate disclosure is a necessity.

The Commission finds the replacement of ULH&P s cast iron and bare steel mains within 10 years to be necessary and in the public interest. We also recognize the significant impact the accelerated main replacement program will have on ULH&P over the next 10 years. The Commission believes we have the statutory authority to establish, and that we should establish, a method of recovery that will help to eliminate any impediment to the success of the program. However, because the AMRP Rider proposal is a case of first impression for the Commission, we believe that it should be established for an initial 3-year period. Having found that the replacement program is in the public interest and having recognized the impact on ULH&P, the Commission finds at this time no reason to believe that the mechanism cannot be continued for 10 years. However, we believe that establishing the Rider for an initial 3-year period will allow both ULH&P and the Commission an opportunity to review the operation of the mechanism and make a decision on its renewal.

We will therefore authorize a modified AMRP Rider, using the revenue requirements concept initially suggested by ULH&P. The actual steps in calculating the annual AMRP Rider, the rate base and costs components included in the AMRP Rider, and the formats to be provided with each annual filing are shown on Appendix G. However, ULH&P will not be permitted to accrue AFUDC beyond the replacement plant in service date; nor will it be permitted to defer depreciation on that plant once its goes into service. Similar to ULH&P s proposal, the rate of return on its AMRP rate base will be the overall cost of capital found reasonable in this proceeding, grossed up for the state and federal income taxes. The effective state income tax rate utilized in this case shall be used. The Commission will require ULH&P to thoroughly document all costs and expenses included in the annual AMRP Rider filings. In light of the situation involving the Lafarge project, discussed later in this Order, the Commission places ULH&P on notice that it will be expected to avoid a repeat of that situation.

The Commission will accept the concept of a per-customer charge for the residential and commercial customers and a volumetric charge for transportation and industrial customers; however, the AMRP Rider must be disclosed as a separate line item on all bills. The AMRP Rider filing will be submitted on March 31 of each year, and the Commission will attempt to process the filing within 60 days. However, because a hearing will be necessary, and because the time needed for review of the filing may be extensive, the Commission will reserve the option of extending the review period. When ULH&P makes its annual filing, it will serve the AG with a complete copy. In addition, certain periodic information relating to the construction under the AMRP will be required. Those information needs and their corresponding filing deadlines are also included in Appendix G.

Therefore, for the reasons mentioned earlier, the Commission believes it is reasonable to authorize the AMRP Rider for an initial 3-year period. The 3-year period will be effective as of the date of this Order. If ULH&P wishes to continue the AMRP Rider, it will need to file a general rate application to roll-in the Rider and to justify its continuation. The Commission believes it will be necessary to examine ULH&P s total gas operations in conjunction with a review to continue the AMRP Rider. It will also allow the Commission the opportunity to roll-in the replacement lines into the base rates of ULH&P and, if the AMRP Rider is continued, prevent the AMRP Rider from becoming too large a portion of the customer bill.

OTHER ISSUES

Certificate of Public Convenience and Necessity

ULH&P argues that a Certificate of Public Convenience and Necessity (CPCN) is not required for its AMRP. It asserts that the statutes and regulations require a CPCN for extensions, not for replacement.[187] The Commission disagrees with ULH&P s interpretation. KRS 278.020(1) provides that a CPCN is required for utility construction "except. . .ordinary extensions of existing systems in the usual course of business." Construct means [t]o adjust and join materials, or parts of, so as to form a permanent whole. To put together constituent parts of something in their proper place and order. Black s Law Dictionary 283 (5th Ed. 1979). The definition of construction includes

[187] ULH&P Brief at 13.

[t]he act of fitting an object for use or occupation in the usual way, and for some distinct purpose. Black s Law Dictionary 283 (5th Ed. 1979). Administrative Regulation 807 KAR 5:001, Section 9(3) defines "usual course of business" construction as [1] that which does not "create wasteful duplication of plant," does not conflict with "service of other utilities," and does not involve sufficient money to "materially affect" the utility's financial condition; or [2] that which does not result in "increased charges" to the utility's customers. The record indicates that the proposed program will involve sufficient capital outlay to materially affect the existing condition of the utility and will ultimately result in increased charges to its customers. Therefore, it is clear that ULH&P s accelerated replacement program is construction, does not meet the ordinary course of business exemption, and requires a CPCN.

As previously discussed, the Commission finds the replacement of ULH&P s old cast iron and bare steel mains an important endeavor and finds that general approval of this construction program should be granted. However, the Commission also finds that specific engineering and construction information is required, as well as more precise information concerning the exact locations at which the construction will occur. Therefore, ULH&P must file an application for a CPCN for its replacement program pursuant to Administrative Regulation 807 KAR 5:001, Sections 8 and 9, and we will expedite our review of the application.

In conjunction with its AMRP, and pursuant to the advice of Stone & Webster,[188] ULH&P stated in its original filing that it also planned to replace the customer-owned cast iron and bare steel service lines when it replaces the mains. ULH&P also indicated

[188] Torpis Direct Testimony at 13.

it intends to replace plastic service lines it encounters as part of the AMRP that do not pass certain pressure tests. It stated that it planned to capitalize these costs as part of the program and to recover them in the proposed AMRP Rider.[189] At the hearing in this matter, ULH&P stated that it would be willing to assume responsibility for all customer service lines on its distribution system as they need maintenance, repair or replacement and to include the costs in the AMRP Rider.[190]

The Commission believes that the ownership of ULH&P s distribution system should be the same throughout. The Commission finds that any customer service lines ULH&P assumes responsibility for that were encountered under circumstances other than in conjunction with the AMRP will not be included in the AMRP Rider mechanism. The Commission is authorizing the AMRP Rider for an initial 3-year period and is requiring ULH&P to file a general rate case to consider the continuation of the AMRP Rider. In that proceeding, ULH&P will have the opportunity to include its investment in these customer service lines it has assumed responsibility for outside of the AMRP.

The Commission finds that before ULH&P can assume responsibility for customer service lines, a deviation from Administrative Regulation 807 KAR 5:022, Section 9(17), is required, regardless of whether this occurs as part of the AMRP or through routine operations. Therefore, ULH&P should include in its application for a CPCN a request for permission to deviate from Administrative Regulation 807 KAR 5:022, Section 9(17).

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[189] Randolph Direct Testimony at 13.

[190] T.E., Volume I, November 28, 2001, at 31.

Investment in Lafarge Pipeline

In Case No. 2000-039,[191] the Commission examined ULH&P s investment in a 12-inch gas pipeline, constructed under the terms of a joint ownership arrangement with the Lafarge Corporation (Lafarge). Lafarge initially intended to by-pass ULH&P and construct an 8-inch pipeline to serve Lafarge s gypsum wallboard plant. However, when approached by residents of the cities of Silver Grove and Melbourne about the possibility of making natural gas available to them, Lafarge and ULH&P negotiated an agreement where the 8-inch pipeline was increased to 12 inches. The agreement provides that Lafarge and ULH&P each owns a one-half share in the pipeline.

ULH&P initially estimated its share of the costs of the Lafarge pipeline to be $175,000, but later indicated its share of the costs would be $476,883.[192] The Commission stated:

> ULH&P s responses to information requests contain conflicting information about the actual installed cost of the 12-inch pipeline. The responses also contained discrepancies concerning allocation of cost between ULH&P and Lafarge. . . We are concerned that ULH&P may be bearing costs in excess of the incremental cost above the purchase order amount of $635,000.[193]

Consequently, the Commission did not approve any amount to be recorded on ULH&P s books for the construction of the Lafarge pipeline.

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[191] Case No. 2000-039, The Union Light, Heat and Power Company s Application for a Certificate of Public Convenience and Necessity, final Order dated August 1, 2000.

[192] Case No. 2000-039, August 1, 2000 Order, at 2.

[193] Id. at 2-3.

During this proceeding, ULH&P has been asked about its investment in the Lafarge pipeline. ULH&P stated that it had booked $498,001[194] as its investment in March 2001; however, other documents submitted by ULH&P indicated the investment at March 2001 was $425,184.[195] ULH&P prepared a reconciliation of these amounts, and has now determined that the booked cost for the Lafarge pipeline should be $468,497. ULH&P s reconciliation indicates that it had originally booked $32,025 in costs that should have been charged to Lafarge.[196] ULH&P has also provided copies of correspondence indicating that there was confusion about the costs of the project in total, that there was confusion about how much of the project costs should be assigned to ULH&P, and that there were affiliate company issues to resolve.[197]

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[194] ULH&P s Response to the Commission Staff s Second Data Request dated July 10, 2001, Item 64(c).

[195] ULH&P s Response to the Commission Staff s Third Data Request dated September 4, 2001, Item 33(f), Attachment page 62 of 66.

[196] ULH&P s Response to the Commission Staff s Hearing Requests, Item 6.

[197] ULH&P s Response to the Commission Staff s Third Data Request dated September 4, 2001, Item 33(f), Attachment pages 60-61 and 64-66 of 66. The Commission is especially concerned by the comment found on Attachment page 66 of 66:

> If we really wanted to adhere to the original agreement for ULH&P to only pay the incremental costs associated with the upgrade to a 12 diameter line, believe me, EPCOM/CBS would be absorbing a much greater amount than the $10,861.91 that we are asking you to take. The non-regulated margin is currently being scrutinized by the KPSC, and I believe we need to transfer these dollars to support our arguments to leave the rest alone. I think we will be able to convince the KPSC that the 50/50 cost split reflects the ownership arrangement on the pipeline, and that the incremental cost argument was not reflective of the site conditions and the difficulty of the pipeline construction.
>
> At this point, it is really irrelevant to me whose work codes get used, whether they be CBS (Vestar) or EPCOM. All I know is that they must be moved from the regulated work order.

The Commission has reviewed the information provided by ULH&P and has determined that the amount of investment in the Lafarge pipeline to be recorded by ULH&P is $467,547.[198] ULH&P should adjust the balance on its books for the Lafarge pipeline to this amount, and file copies of the accounting entries with the Commission within 30 days of the date of this Order.

In addition, the Commission is concerned by the apparent inability of ULH&P and Cinergy to properly track and assign costs on this project between regulated and unregulated operations. The Commission believes its is reasonable to assume this will not be the last time ULH&P will be involved in a construction project with one or more Cinergy unregulated affiliates. It is imperative that ULH&P and Cinergy have in place mechanisms to reasonably ensure that cost allocations to ULH&P do not result in the subsidization of Cinergy s unregulated affiliates.

The work order system utilized by ULH&P and Cinergy should be designed in such a manner as to readily disclose the total costs of a project at any time and the assignment of those costs to regulated and unregulated operations. It is apparent from the Lafarge project that either the work order system is lacking in this regard or the established procedures were not followed. The Commission believes that the work order system currently utilized by ULH&P and Cinergy needs modification. ULH&P should make modifications to its work order system to improve the overall reporting of the costs of a project and the assignment of those costs between regulated and

[198] This amount reflects the revised amount of $468,497 reduced by $950 in invoices incorrectly charged to the Lafarge project by Asplundh Construction Corp. and SKJ Construction, Inc. See ULH&P s Response to the Commission Staff s Third Data Request dated September 4, 2001, Item 32(b).

unregulated operations. ULH&P should file a report with the Commission within 90 days of the date of this Order detailing the modifications it has instituted to improve its work order system.

Quarterly Financial Reports

As noted previously in this Order, ULH&P does not routinely prepare separate balance sheets for its electric and gas operations. In explaining why it does not prepare these financial statements, ULH&P states:

> ULH&P does not prepare separate balance sheets for its gas and electric operations because preparation of such statements would result in significant additional administrative cost, would require certain accounts to be capriciously allocated to each service, and would not be meaningful in state or federal regulatory rate setting proceedings nor in the monitoring of the financial performance of each regulated business.[199]

The Commission finds it extraordinary that ULH&P would claim that separate balance sheets would not be meaningful in regulatory rate setting proceedings and the monitoring of the financial performance of each regulated business. The Commission reminds ULH&P that it is comprised of two regulated businesses, electric service and gas service. The rates charged for each service must be fair, just, and reasonable, based on each business s operations, not on a combined basis. Contrary to ULH&P s claim, this Commission finds it meaningful and necessary to have financial statements and information presented on each business s operations in order to monitor financial performance.

Therefore, the Commission finds that ULH&P should be required to file as a supplement to its monthly financial reports a set of financial statements separating its

[199] ULH&P s Response to the Commission Staff s Third Data Request dated September 4, 2001, Item 11(a).

electric and gas operations. These supplemental financial statements should be filed quarterly, and should be filed no later than 45 days after the close of the reporting quarter. The supplemental financial statements will consist of a balance sheet and income statement. The Commission realizes that ULH&P will have to allocate several of the account balances reported on these statements, but ULH&P should already be well equipped to perform such allocations. The format for these financial statements is shown on Appendix H. The first quarterly supplement financial statements will cover the quarter ended June 30, 2002.

Effective Date of Rates

In its January 18, 2002 letter, ULH&P gave notice of its intent to place its proposed rates in effect, subject to refund, if our decision Order was not issued by January 30, 2002. ULH&P requested if the Order were issued prior to that date, that the rates be made effective for meters read on January 31, 2002, and bills rendered on and after February 4, 2002, which reflects the first billing cycle of its February 2002 revenue month. No objection or filing in opposition to this request was received from the AG.

KRS 278.190(2) permits a utility, after notice to the Commission, to place rates into effect if a decision has not been rendered by the end of the suspension period. The Commission believes that rates may only go into effect for services rendered on and after the date of notice, not for meter readings that reflect rates for services rendered prior to notice. Therefore, the Commission finds that the rates found reasonable herein shall be effective for service rendered on and after January 31, 2002.

SUMMARY

The Commission, after consideration of all matters of record and being otherwise sufficiently advised, finds that:

1. The rates set forth in Appendix A are the fair, just, and reasonable rates for ULH&P to charge for service render on and after January 31, 2002.

2. The rates proposed by ULH&P would produce revenue in excess of that found reasonable herein and should be denied.

3. The depreciation rates contained in the depreciation study filed in this case are reasonable and should be approved for use as of the date of this Order.

4. The deferred debits recorded by ULH&P for the Cinergy merger-related expenses should be removed from its books and the accounting entries reflecting this adjustment should be filed with the Commission within 30 days of the date of this Order.

5. The various tariff additions, cancellations, and modifications proposed by ULH&P, with the exception of the AMRP Rider, are reasonable and should be approved.

6. The AMRP Rider as proposed by ULH&P is not reasonable and should be denied.

7. The AMRP Rider, as modified and discussed herein, is reasonable and should be approved. The AMRP Rider should be authorized for an initial period of 3 years from the date of this Order.

IT IS THEREFORE ORDERED that:

1. The rates in Appendix A are approved for service rendered on and after January 31, 2002.

2. The rates proposed by ULH&P are denied.

3. ULH&P shall, within 20 days of the date of this Order, file its revised tariff sheets setting out the rates approved herein.

4. The proposed revisions to Rate IT, Rate FT, and Rider X and the proposed cancellation of Rate SS are approved.

5. The proposed Rate AS, Rate DGS, Rate FRAS, Rate GCAT, Rate GTS, Rate IMBS, and Rate SSIT are approved.

6. The AMRP Rider as proposed by ULH&P is denied. The AMRP Rider, as modified and discussed herein, is approved for an initial period of 3 years from the date of this Order.

7. The depreciation rates contained in the depreciation study submitted in this case are approved for use as of the date of this Order.

8. Within 30 days of the date of this Order, ULH&P shall file copies of its accounting entries removing deferred Cinergy merger-related expenses from its books.

9. Within 30 days of the date of this Order, ULH&P shall file copies of its accounting entries adjusting the investment in the Lafarge pipeline to $467,547.

10. Within 90 days of the date of this Order, ULH&P shall file a report detailing the modifications its has made to its work order system to improve the cost reporting and the assignment of costs between regulated and unregulated operations.

11. Beginning with the quarter ending June 30, 2002, ULH&P shall file supplemental financial statements, using the format shown on Appendix H. These supplemental financial statements shall be filed quarterly and shall be filed with the Commission no later than 45 days after the end of the reporting quarter.

Done at Frankfort, Kentucky, this 31st day of January, 2002.

By the Commission

ATTEST:

Thomas M. Dorman

Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2001-00092 DATED January 31, 2002

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 rates included herein reflect all gas cost adjustments through Case No. 92-346-NN.

Rate RS
RESIDENTIAL SERVICE

Customer Charge per Month: $8.30

	Base Rate		Gas Cost Adjustment		Total Rate
Commodity Charge for All CCF Consumed	23.02¢	plus	56.83¢	equals	79.85¢ per CCF

RATE GS
GENERAL SERVICE

Customer Charge per Month: $15.35

	Base Rate		Gas Cost Adjustment		Total Rate
Commodity Charge for All CCF Consumed	20.41¢	plus	56.83¢	equals	77.24¢ per CCF

RATE FT-LARGE
FIRM TRANSPORTATION-LARGE

Administrative Charge per Month: $330.00

Commodity Charge for
All CCF Consumed 17.14¢ per CCF

RATE IT
INTERRUPTIBLE TRANSPORTATION

Administrative Charge per Month:	$330.00
Commodity Charge for All CCF Consumed	7.15¢ per CCF

APPENDIX B

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2001-00092 DATED January 31, 2002

The jurisdictional net original cost rate base of ULH&P s combined and gas operations at September 30, 2000 is as follows:

	Combined	Gas
Total Utility Plant in Service	$439,762,221	$182,860,221
Add:		
Materials & Supplies		
Gas Enricher Liquids	655,260	655,260
Other Materials & Supplies	327,439	135,355
Stores Expense Undistributed	365,086	0
Total Materials & Supplies	1,347,785	790,615
Prepayments	16,349	16,349
Gas Stored Underground	3,849,839	3,849,839
Cash Working Capital Allowance	4,876,349	2,123,324
Subtotal	10,090,322	6,780,127
Deduct:		
Reserve for Accum. Depreciation	158,499,678	62,080,678
Accum. Deferred Income Taxes	35,559,888	14,592,939
Accum. Deferred Income Taxes FAS 109	13,119,736	6,086,793
Investment Tax Credits (3 percent)	73,859	73,859
Customer Advances for Construction	3,891,599	3,891,599
Subtotal	211,144,760	86,725,868
Jurisdictional Net Original Cost Rate Base	$238,707,783	$102,914,480

Ratio of Kentucky jurisdictional gas operations to jurisdictional Total Company operations is 43.113 percent.

NOTES:

1. Combined amounts are on a Kentucky jurisdictional basis.

2. Balances for Materials & Supplies, Prepayments, and Gas Stored Underground were determined using 13-month average balances.

3. Prepayments do not include amounts for the PSC Assessment.

4. Cash working capital allowance was determined by taking 1/8th of test-year-end actual operations and maintenance expenses less purchased power and purchased gas costs.

5. Deferred Cinergy merger-related expenses and the unamortized balance of ULH&P s 1992 downsizing expenses have been excluded from the calculation of these rate bases.

APPENDIX C

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2001-00092 DATED January 31, 2002

DETERMINATION OF JURISDICTIONAL GAS CAPITALIZATION AND GAS CAPITAL STRUCTURE

Determination of Total Company Jurisdictional Capitalization:

	Total Company Balances 09/30/2000	Capital Structure Percentage	Non-Jurisdictional Adjustment	Total Company Jurisdictional Balances
Long-Term Debt	$ 71,402,645	26.857%	($ 6,562,253)	$ 64,840,392
Short-Term Debt	54,276,650	20.415%	(4,988,211)	49,288,439
Common Equity	140,182,297	52.728%	(12,883,585)	127,298,712
Total Long-Term Debt, Short-Term Debt, and Common Equity	$265,861,592	100.000%	($24,434,049)	$241,427,543

To arrive at the jurisdictional gas capitalization, the jurisdictional rate base ratio of 43.113 percent is applied to each component of the total company jurisdictional balances.

Determination of Jurisdictional Gas Capitalization:

	Jurisdictional Gas Balances 09/30/2000	Allocation Of Gas JDIC	Adjusted Gas Balance	Adjusted Gas Capital Structure
Long-Term Debt	$ 27,954,638	$ 473,405	$ 28,428,043	26.857%
Short-Term Debt	21,249,725	359,853	21,609,578	20.415%
Common Equity	54,882,294	929,430	55,811,724	52.728%
Total Long-Term Debt, Short-Term Debt, and Common Equity	$104,086,657	$ 1,762,688	$105,849,345	100.000%
Gas JDIC	1,762,688	(1,762,688)	0	
Total Capitalization	$105,849,345	$ 0	$105,849,345	

APPENDIX C (continued)

Determination of Non-Jurisdictional Adjustment:

	Non-Jurisdictional Electric	Non-Jurisdictional Gas	Total Non-Jurisdictional
Non-Jurisdictional Rate Base Items -			
Utility Plant in Service	$13,947,000	$16,364,065	$30,311,065
CWIP	0	122,000	122,000
Gas Enricher Liquids (Propane)	0	1,216,910	1,216,910
Reserve for Accumulated Depreciation	(970,000)	(6,687,523)	(7,657,523)
Accumulated Deferred Income Taxes	0	393,530	393,530
Accum. Deferred Income Taxes FAS 109	46,126	3,572	49,698
Investment Tax Credits (3%)	0	(1,631)	(1,631)
Total Net Non-Jurisdictional Adjustment	$13,023,126	$11,410,923	$24,434,049

NOTES:

1. The Total Non-Jurisdictional Adjustment has been allocated to the components of capitalization utilizing the capital structure percentages.

2. The balance for the Gas JDIC was taken from Application Schedule B-6, lines 6 and 7. The JDIC treatment is consistent with previous Commission decisions.

APPENDIX D

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2001-00092 DATED January 31, 2002

DETERMINATION OF ADJUSTMENT FOR
CHARITABLE CONTRIBUTIONS, ADVERTISING EXPENSES, AND MISCELLANEOUS EXPENSES

Proposed by ULH&P Application Schedule D-2.2:

Various Charitable Contributions recorded as O&M	$ 7,839
Marketing/Customer Relations	727
Community Relations	22,066
Advertising Expenses	3,183
Other Miscellaneous	1,447
Total Adjustment Proposed by ULH&P	$ 35,262

Proposed by AG Henkes Direct Testimony, Schedule RJH-16:

Stock Option Loan Expenses	$ 15,193
Ohio Rate Case Expense	151
Company Picnic Expenses	347
Remove EPRI expenses allocated to gas	570
Remove Legislative Exchange Council Expenses	358
Remove Miscellaneous Non-Jurisdictional	966
Remove Government Affairs Expenses	7,371
Total Adjustment Proposed by AG	$ 24,956
Combined ULH&P and AG Proposals	$ 60,218

Commission Adjustments:

Remove double count of Repeal PUHCA Now expense, Account No. 928 portion, removed by ULH&P in Schedule D-2.6	(397)
Remove EEI charges for on-line utility information	3
Midwest Energy Association expense	3,179
Science Applications International Real Time Pricing	1,377
Total Adjustment to Operating Expenses	$ 64,380

The AG s adjustment as shown on RJH-16 included a $2,985 adjustment for injuries and damages which is addressed separately in the Order.
Commission adjustments can be found in ULH&P s responses to Commission Staff First, Item 26, page 23 of 56; Commission Staff First, Item 25(b); and Commission Staff Second, Item 43(a)(3), page 20 of 25.

APPENDIX E

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2001-00092 DATED January 31, 2002

INTEREST SYNCHRONIZATION CALCULATION

	Long-Term Debt	Short-Term Debt
Capital Structure Percentages	26.857%	20.415%
Debt Portion of Jurisdictional Gas Capitalization	$28,428,043	$21,609,578
Less: Jurisdictional Gas CWIP Subject to AFUDC		
$1,804,000 times 26.857%	484,500	0
$1,804,000 times 20.415%	0	368,287
Debt Component less Applicable Portion of Gas CWIP Subject to AFUDC	27,943,543	21,241,291
Debt Component multiplied by appropriate Annual Cost Rate	7.296%	3.545%
Annualized Gas Interest Expense for each Debt Component	$ 2,038,761	$ 753,004
Total Annualized Gas Interest Expense		$ 2,791,765
Test Year Actual Gas Interest Expense (calculated)		2,119,559
Increase in Gas Interest Expense		$ 672,206

Determination of Income Tax Effect:

Increase in Gas Interest Expense		$ 672,206
Kentucky Income Tax Rate (stated)		8.25%
Kentucky Income Tax Effect of Increased Gas Interest Expense		$ (55,457)
Increase in Gas Interest Expense	$ 672,206	
Less: Kentucky Income Tax Effect	(55,457)	
Increase in Gas Interest Expense Federal		$ 616,749
Federal Income Tax Rate		35.00%
Federal Income Tax Effect of Increased Gas Interest Expense		$ (215,862)
Total Income Tax Effect of Increased Gas Interest Expense		$ (271,319)

NOTES:

1. The CWIP Subject to AFUDC is from Application Schedule B-4.

2. The calculation of the Test Year Actual Gas Interest Expense is shown on the second page of this Appendix.

APPENDIX E (continued)

Calculation of Test Year Actual Gas Interest Expense:

ULH&P reported its book interest expense for the test year on a total company basis. In order to calculate the Interest Synchronization adjustment, it has been necessary to allocate the test-year expense between electric and gas operations, as shown below.

Test-Year Actual Interest on Long-Term Debt:

Total Company Interest on Long-Term Debt (Commission Staff First, Item 6)	$4,068,000
Jurisdictional Rate Base Ratio	43.113%
Interest on Long-Term Debt Gas	$1,753,837

Test-Year Actual Interest on Short-Term Debt:

Test-Year Other Interest Expense was taken from Commission Staff First, Item 6. Total test-year Other Interest Expense includes items not included in the determination of short-term interest expense. To remove these items, the Commission has allocated the test-year Other Interest Expense to reflect the mix of items reported in ULH&P s FERC Form 2 for 2000.

	FR #6-m FERC Form 2 Page 340	Percentage of Total from FERC Form 2	Test Year Other Interest Expense
Account No. 430 Interest on Debt to Assoc. Cos.			
Moneypool ULH&P to PSI	$ 719,655	55.872%	$ 522,403
Moneypool ULH&P to CG&E	427,169	33.164%	310,083
Account No. 431 Other Interest Expense			
Commercial Paper	1,144	0.089%	832
Capital Lease	54,360	4.220%	39,457
Interest Assigned from Service Company	(53,557)	-4.158%	(38,877)
Interest Other	19,819	1.539%	14,390
Customer Service Deposits	113,000	8.773%	82,028
Gas Refund PUCO Rule 28	6,450	0.501%	4,684
Total Account Nos. 430 & 431	$1,288,040	100.000%	$ 935,000
Remove Interest Expense not included for Short-Term Debt			
Customer Service Deposits			(82,028)
Gas Refund PUCO Rule 28			(4,684)
Allocated Interest Expense on Short-Term Debt Total Company			$ 848,288
Jurisdictional Rate Base Ratio			43.113%
Interest on Short-Term Debt Gas			$ 365,722
Total Test Year Gas Interest Expense			$2,119,559

APPENDIX F

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2001-00092 DATED January 31, 2002

INCOME TAX EXPENSES REFLECTING
USE OF EFFECTIVE KENTUCKY INCOME TAX RATE

This calculation is modeled on approach used by ULH&P, as shown in Application Workpapers WPD-2.25a and WPD-2.25b.

Adjusted Operating Income before Federal and Kentucky Income Taxes		$10,703,918
Less: Annualized Interest Expense		2,791,765
Unadjusted Operating Income before Taxes		7,912,153
Effective Kentucky Income Tax Rate	2000	3.03%
Adjusted Kentucky Income Tax Expense		$ 239,738
Adjusted Kentucky Income Tax Expense before Adjustment to Effective Rate		834,113
Kentucky Income Tax Adjustment		$ (594,375)
Kentucky Income Tax Adjustment		$ (594,375)
Effective Federal Income Tax Rate		35.00%
Adjustment to Federal Income Tax Expense		$ 208,031

APPENDIX G

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2001-00092 DATED January 31, 2002

AMRP RIDER PERIODIC REPORTING AND ANNUAL FILING FORMATS

This Appendix includes the filing formats ULH&P will prepare when submitting its application for the annual adjustment to the AMRP Rider. ULH&P will not modify any filing format without prior consent of the Commission Staff.

In order for the Commission to properly monitor the accelerated main replacements, ULH&P will need to provide the following information:

1) A list of the names and addresses of the contractors utilized for AMRP projects.

2) A copy of the bid document signed with each contractor showing a description and scope of the work, construction specifications, and construction management.

3) Construction schedule for each job.

4) Reasonable size maps for each location.

5) A 3-month progress report showing the manner of replacing the pipes, progress and percentage of job finished, pressure testing, pictures, etc.

6) Copies of updated welding certification for each welder kept on site for inspection by the Commission s investigator.

7) Annual progress report for work completed, the amount of a progress payment and the costs of removal of the old pipes.

Items 1 through 3 are to be filed as contracts are issued. Items 4 and 6 are to be filed at the beginning of each project. Item 5 will be dependent upon the starting date of each project. Item 7 will be filed along with ULH&P s application for the annual adjustment of the AMRP Rider. ULH&P may request a conference with the Commission s Engineering Staff if clarifications are needed concerning Items 1 through 7.

The Union Light, Heat and Power Company
Annual AMRP Rider Filing

Determination of Annual Revenue Requirement   Page 1

	Investment Reflected In Base Rates	AMRP for 12-Months Ending {Date}	Cumulative AMRP To Date
Return on Investment:			
Original Cost of Plant in Service			
Mains Cast Iron			
Mains Bare Steel			
Mains Plastic			
Services Cast Iron			
Services Bare Steel			
Services Plastic			
Meter Relocations			
Customer Service Lines			
A. Total Original Cost of Plant in Service			
Accumulated Depreciation			
Mains Cast Iron			
Mains Bare Steel			
Mains Plastic			
Services Cast Iron			
Services Bare Steel			
Services Plastic			
Meter Relocations			
Customer Service Lines			
B. Total Accumulated Depreciation			
C. Deferred Income Taxes Associated with Referenced Plant in Service			
Net Rate Base for AMRP Purposes (A B C)			
Authorized Rate of Return, adjusted for Income Taxes	11.885%	11.885%	11.885%
D. Return on AMRP Related Investment			
Operating Expenses:			
Depreciation Expense			
Mains Cast Iron			
Mains Bare Steel			
Mains Plastic			
Services Cast Iron			
Services Bare Steel			
Services Plastic			
Meter Relocations			
Customer Service Lines			
Maintenance Expense Account 887			
E. Total Operating Expenses			
Total Annual Revenue Requirements (D + E)			
Increase (Decrease) in Annual Revenue Requirements			

The Union Light, Heat and Power Company
Annual AMRP Rider Filing

Determination of Annual Revenue Requirement Page 2

Calculation of Authorized Rate of Return:

	% of Total Capital	Cost Rate Allowed	Weighted Aver. Cost of Capital	Gross-Up Factor	Authorized Rate of Return
Long-Term Debt	26.857%	7.296%	1.959%		1.959%
Short-Term Debt	20.415%	3.545%	0.724%		0.724%
Common Equity	52.728%	11.000%	5.800%	1.586546	9.202%
Totals	100.000%		8.483%		11.885%

Supporting Schedules:

Overall Project Recap & Summary

	Miles Replaced under AMRP	Total Cost of Replacement under ARMP	Percentage of Total AMRP Completed to Date
Original from Information submitted in Case No. 2001-00092			NA
Status of Total AMRP as of this Filing			

With each annual filing, ULH&P will prepare an Overall Project Recap & Summary. This schedule will compare information originally submitted in Case No. 2001-00092 with the current status of the AMRP as of the date of the filing.

The Union Light, Heat and Power Company
Annual AMRP Rider Filing

Determination of Annual Revenue Requirement   Page 3

Plant in Service Added Through AMRP

Project Identifier (Work Order Ref. #or Contract Ref.)	Date Project Started	Percentage Completed	Costs for Current 12 Months	Cumulative Total Project Costs
Mains Plastic				
(List Separately)				
Services Plastic				
(List Separately)				
Meter Relocations				
(List Separately)				
Customer Service Lines				
(List Separately)				
Totals				

All projects and/or jobs performed in association with AMRP will be included in this schedule. Each project or job will be identified by its Work Order Reference Number or a Contract Reference. ULH&P will maintain supporting documentation to support any cost shown on this schedule. Additional pages may be required for this supporting schedule.

The Union Light, Heat and Power Company
Annual AMRP Rider Filing

Determination of Annual Revenue Requirement Page 4

Plant in Service Retired/Removed Through AMRP -

Project Identifier (Retirement Work Order Ref. #)	Date Project Started	Percentage Completed	Total Investment Retired or Removed
Mains Cast Iron			
(List Separately)			
Mains Bare Steel			
(List Separately)			
Services Cast Iron			
(List Separately)			
Services Bare Steel			
(List Separately)			
Meter Relocations			
(List Separately)			
Totals			

All retirements or replacements performed in association with AMRP will be included in this schedule. Each retirement or replacement will be identified by its Retirement Work Order Reference Number. ULH&P will maintain supporting documentation to support any cost shown on this schedule. Additional pages may be required for this supporting schedule.

Maintenance Expense Account 887

In support of the amounts reported for Account 887, ULH&P will submit a detailed schedule of the identified expenses. This schedule will include, at a minimum: a document or journal reference, the name of the vendor, the date of the transaction, the cost allocated to ULH&P s gas operations, and a description of the transaction. Any expenses included in this supporting schedule resulting from an allocation of costs from CG&E or Cinergy Services will also be detailed in the manner described. ULH&P will maintain any additional supporting documentation to support any expense shown on this schedule.

The Union Light, Heat and Power Company
Annual AMRP Rider Filing

Determination of Annual Revenue Requirement   Page 5

Calculation of Depreciation Expense and Accumulated Depreciation -

Depreciable Plant in Service	Depreciation Rate	Beginning Accumulated Depreciation Balance	Depreciation Expense for Current 12 Months	Adjustments Due to Retirement or Replacement	Ending Accumulated Depreciation Balance
Mains Cast Iron					
Mains Bare Steel					
Mains Plastic					
Services Cast Iron					
Services Bare Steel					
Services Plastic					
Meter Relocations					
Customer Service Lines					
Totals					

The balances shown for accumulated depreciation and the calculation of depreciation expense will be shown on this schedule. ULH&P will maintain supporting documentation to support any cost shown on this schedule. Additional pages may be required for this supporting schedule.

Customer Service Lines

Project Identifier (Work Order Ref. # or Contract Ref.)	Date Project Started	Cost of Lines Added Due to AMRP	Cost of Lines Added Due to Normal Operations
(List Each Project Separately)			
Totals			

This schedule will reflect those customer service lines ULH&P assumes ownership for in conjunction with AMRP and those assumed during the normal repairs, maintenance, or replacement. Only those customer service lines ULH&P assumes ownership over in conjunction with AMRP can be included for recovery through the AMRP Rider mechanism. ULH&P will maintain supporting documentation to support any cost shown on this schedule. Additional pages may be required for this supporting schedule.

APPENDIX H

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2001-00092 DATED January 31, 2002

QUARTERLY SUPPLEMENTAL
FINANCIAL STATEMENT FORMATS

This Appendix includes the formats ULH&P will prepare when submitting its Quarterly Supplement Financial Statements. ULH&P will not modify any format without prior consent of the Commission Staff.

The Commission recognizes the fact that ULH&P will need to utilize numerous allocation factors to develop these financial statements. ULH&P will need to be able to explain the rationale supporting the selected allocation factors when requested. ULH&P will maintain supporting documentation to support any item included on these financial statements. The Quarterly Supplement Financial Statements are due no later than 45 days after the close of the reporting quarter. Income Statements will reflect 12 months of activity.

The attached formats separate the balance sheet and income statement into electric jurisdictional, gas jurisdictional, combined non-jurisdictional, and total company operations. ULH&P should follow its normal processes for allocating common plant and other common items between the electric, gas, and non-jurisdictional classifications. While the formats do not require the non-jurisdictional operations to be separated into electric and gas, ULH&P may do so and reflect this additional split on the financial statements, if it will make the preparation of the financial statements easier for ULH&P.

<u>The Union Light, Heat and Power Company</u>

Quarterly Supplement Financial Statements
Balance Sheet Page 1
As of {Date}

	Electric Jurisdictional	Gas Jurisdictional	Non-Jurisdictional	Total Company
Assets				
Utility Plant in Service				
Construction Work in Progress				
Less Accum. Depreciation				
Net Utility Plant				
Nonutility Property				
Other Investments				
Special Funds				
Total Other Property & Investments				
Cash				
Special Deposits				
Working Funds				
Temporary Cash Investments				
Notes Receivable				
Customer Accounts Receivable				
Other Accounts Receivable				
Less Provision for Uncollectibles				
Notes Receivable from Assoc. Co.				
Accounts Receivable from Assoc. Co.				
Fuel Stock				
Plant Materials & Operating Supplies				
Other Materials & Supplies				
Stores Expense Undistributed				
Gas Stored Underground Current				
Prepayments				
Interest & Dividends Receivable				
Misc. Current & Accrued Assets				
Total Current & Accrued Assets				
Unamortized Debt Expense				
Extraordinary Property Losses				
Other Regulatory Assets				
Preliminary Survey & Investigation				
Clearing Accounts				
Temporary Facilities				
Miscellaneous Deferred Debits				
Unamortized Loss on Reacquired Debt				
Accumulated Deferred Income Taxes				
Unrecovered Purchased Gas Costs				
Total Deferred Debits				
TOTAL ASSETS AND OTHER DEBITS				

The Union Light, Heat and Power Company

Quarterly Supplement Financial Statements
Balance Sheet Page 2
As of {Date}

	Electric Jurisdictional	Gas Jurisdictional	Non-Jurisdictional	Total Company
Proprietary Capital				
Common Stock Issued				
Premium on Capital Stock				
Other Paid-in Capital Stock				
Less Capital Stock Expense				
Retained Earnings				
Total Proprietary Capital				
Liabilities				
Bonds				
Less Reacquired Bonds				
Other Long-Term Debt				
Unamortized Premium on Long-Term Debt				
Less Unamortized Discount on Long-Term Debt				
Less Current Portion of Long-Term Debt				
Total Long-Term Debt				
Obligations Under Capital Leases Noncurrent				
Accum. Provision for Injuries & Damages				
Accum. Misc. Operating Provisions				
Total Other Noncurrent Liabilities				
Current Portion of Long-Term Debt				
Notes Payable				
Accounts Payable				
Notes Payable to Assoc. Co.				
Accounts Payable to Assoc. Co.				
Customer Deposits				
Taxes Accrued				
Interest Accrued				
Tax Collections Payable				
Misc. Current & Accrued Liabilities				
Obligations Under Capital Leases Current				
Total Current & Accrued Liabilities				
Customer Advances for Construction				
Accum. Deferred Investment Tax Credits				
Other Deferred Credits				
Other Regulatory Liabilities				
Accumulated Deferred Income Taxes				
Total Deferred Credits				
TOTAL PROPRIETARY CAPITAL, LIABILITIES, AND OTHER DEFERRED CREDITS				

The Union Light, Heat and Power Company

Quarterly Supplement Financial Statements
Income Statement
For the 12 Months Ending {Date}

	Electric Jurisdictional	Gas Jurisdictional	Non-Jurisdictional	Total Company
Revenues				
Residential Sales				
Commercial Sales				
Industrial Sales				
Sales to Public Authorities				
Public Street & Highway Lighting				
Forfeited Discounts				
Misc. Service Revenues				
Revenues from Transportation				
Rents from Property				
Interdepartmental Rents				
Other Revenues				
Less Provision for Rate Refunds				
Total Revenues				
Operating Expenses				
Operation Expense				
Maintenance Expense				
Depreciation Expense				
Amortization and Depletion				
Taxes Other than Income Taxes				
Income Taxes Federal & Other				
Provision of Deferred Income Taxes Net				
Investment Tax Credit Adjustment				
Total Operating Expenses				
NET OPERATING INCOME				
Other Income & Deductions				
Revenues from Merchandising, Jobbing, and Contract Work				
Less Expense of Merchandising, Jobbing, and Contract Work				
Revenues from Nonutility Operations				
Less Expenses from Nonutility Operations				
Interest & Dividend Income				
AFUDC				
Gain on Disposition of Property				
Loss on Disposition of Property				
Misc. Income Deductions				
Taxes Other than Income Taxes				
Income Taxes Federal & Other				
Provision for Deferred Income Taxes Net				
Total Other Income & Deductions				
Extraordinary Items after Taxes				
NET INCOME				