

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF THE UNION LIGHT,)
HEAT AND POWER COMPANY FOR) CASE NO. 2003-00024
DEVIATION FROM THE REQUIREMENTS)
OF KRS 278.2207(1)(b))

O R D E R

On January 16, 2003, The Union Light, Heat and Power Company (ULH&P) submitted an application seeking a deviation from the requirements of KRS 278.2207(1)(b) that would permit Cinergy Marketing & Trading (CM&T), an affiliate of ULH&P, to act as its asset manager.

BACKGROUND

On December 1, 2001, following a competitive bidding process, ULH&P entered into an asset management agreement with Mirant Americas Energy Marketing, LP (Mirant).¹ The agreement provided for Mirant to manage ULH&P s gas supply assets from December 1, 2001 through October 31, 2003 and to pay ULH&P a monthly management fee. Mirant and ULH&P were subsequently unable to reach an agreement regarding how Mirant would establish financial responsibility for the assignment of ULH&P s 2002-2003 winter gas supply contracts to Mirant. Consequently, on

¹ Agreement Between Mirant Americas Energy Marketing, LP and The Union Light, Heat and Power Company for Portfolio Management Service and the Purchase of Natural Gas.

November 1, 2002, ULH&P agreed to an assignment of the agreement to ULH&P's affiliate, CM&T, and to a renegotiation of the management fee.² On December 1, 2002, ULH&P and CM&T entered into an agreement that reduced the management fee that CM&T would pay ULH&P.³

On May 16, 2003, the Attorney General of the Commonwealth of Kentucky, by and through his Office for Rate Intervention (Attorney General), moved the Commission for full intervenor status in this action.

DISCUSSION

ULH&P is a Kentucky corporation engaged in the business of selling and distributing natural gas within the Commonwealth of Kentucky and is regulated by the Commission as a utility under KRS 278.010(3)(b). CM&T is an affiliate of ULH&P and is engaged in the business of marketing natural gas and electricity. Since CM&T is an affiliate of ULH&P, the transaction between them is governed by KRS 278.2207. The applicable sections of KRS 278.2207 provide:

(1) The terms for transactions between a utility and its affiliates shall be in accordance with the following:

(b) Services and products provided to the utility by an affiliate shall be priced at the affiliate's fully distributed cost but in no event greater than market or in compliance with the utility's existing USDA, SEC, or FERC approved cost allocation methodology.

² Assignment Agreement By and Among Mirant Americas Energy Marketing, LP as Assignor and Cinergy Marketing & Trading, LP as Assignee and The Union Light, Heat and Power Company as Counterpart (Assignment Agreement) dated November 1, 2002.

³ Second Amendment to Agreement Between Cinergy Marketing & Trading, LP and The Union Light, Heat and Power Company for Portfolio Management Service and the Purchase of Natural Gas (Second Amendment).

(2) A utility may file an application with the commission requesting a deviation from the requirements of this section for a particular transaction or class of transactions. The utility shall have the burden of demonstrating that the requested pricing is reasonable. The commission may grant the deviation if it determines the deviation is in the public interest.

ULH&P states that, in essence, there are two different commodity products that are provided under the Asset Management Agreement. ULH&P purchases gas from CM&T and CM&T purchases ULH&P's interstate pipeline transportation capacity. ULH&P states that it is unable to establish that the commodity transactions are priced at CM&T's fully distributed costs and states that the gas purchases under the management agreement are at market price. As such, the transaction does not comply with the pricing requirements of the statute.

ULH&P asserts that the pricing is reasonable and that the public interest will be served if the requested deviation is granted. ULH&P states that it had concerns regarding Mirant's financial condition and creditworthiness and that it was unable to reach an agreement regarding Mirant's ability to post adequate security for ULH&P's winter gas supply contracts. ULH&P further states that it had additional concerns that Mirant would file bankruptcy and that its storage gas would come under the control of the bankruptcy trustee. In addition, ULH&P states that there was not sufficient time to conduct a competitive bidding process for management of its assets because it needed to have a new asset manager in place prior to the start of the winter season.

ULH&P states that, of the six companies that submitted the lowest bids for its asset management, only two were still providing management services that were credit-worthy and that CM&T was one of the two. It further states that Mirant had informed

ULH&P that it had tried to assign the agreement to other companies prior to assigning it to CM&T, but that the other companies had refused.

The Commission, having considered the record and being otherwise sufficiently advised, finds that ULH&P's concerns with Mirant's financial condition were not unfounded, that ULH&P's transaction with CM&T is reasonable, and that the transaction should be beneficial to ULH&P and its customers. Therefore, the Commission finds that ULH&P's request to deviate from the provisions of KRS 278.2207(1)(b) should be granted. However, this deviation applies only to the assignment of the Mirant asset management agreement that is in effect through October 31, 2003. We find that, if ULH&P wishes to continue to contract for outside asset management, it should utilize a competitive bidding process as it has done in the past.

The Commission also finds that ULH&P should provide a comparison of the cost of the gas it obtained from CM&T to the indices cited in the Request for Proposals submitted under confidentiality in Case No. 2003-00150.⁴ The filing of this comparison should be dependent on ULH&P's future decisions about continuing its relationship with CM&T as its asset manager. If, through the competitive bidding process, ULH&P determines that CM&T should continue as the asset manager beyond October 31, 2003, ULH&P should file this comparison along with its application seeking a further

⁴ Case No. 2003-00150, Application of The Union Light, Heat and Power Company for Deviation from the Requirements of KRS 278.2207(1)(b) to Permit Summer 2003 Natural Gas Purchases from Cinergy Marketing & Trading, LP, an Affiliate.

deviation of KRS 278.2207(1)(b).⁵ If ULH&P does not continue to retain CM&T as its asset manager after October 31, 2003, ULH&P should file this comparison with the Commission no later than November 15, 2003.

The Commission further finds that the Attorney General's motion for intervention is authorized by statute and should be approved.

IT IS THEREFORE ORDERED that:

1. The Attorney General's motion for intervention is granted.
2. ULH&P's request to deviate from the provisions of KRS 278.2207(1)(b), as provided by KRS 278.2207(2), is granted.
3. This deviation applies only to the transaction between ULH&P and CM&T for asset management services through October 31, 2003 as set forth in the Assignment Agreement and Second Amendment.
4. ULH&P shall file a comparison report with the Commission in the manner and by the dates described in this Order

⁵ ULH&P is reminded that it is required to seek prior Commission approval for any and all transactions with CM&T. See Case No. 2002-00375, Application of The Union Light, Heat and Power Company for a Deviation to Allow The Union Light, Heat and Power Company to Purchase Natural Gas from Cinergy Marketing & Trading (final Order dated November 1, 2002).

Done at Frankfort, Kentucky, this 1st day of July, 2003.

By the Commission

ATTEST:


Executive Director