COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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	)	CASE NO. 2003-00150

<u>O R D E R</u>

On May 1, 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) to permit ULH&P to purchase natural gas from an affiliated company, Cinergy Marketing & Trading (CM&T) during summer 2003. ULH&P requests that the Commission issue its decision by May 23, 2003. ULH&P also requests that the Commission grant it permission to deviate from the provisions of KRS 278.2213(6) if the Commission determines that the transaction between ULH&P and CM&T is not in compliance with the arm s length provisions thereof.

On May 19, 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.

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. The relationship between ULH&P and CM&T requires that the pricing for the proposed transaction must comply with KRS 278.2207(1)(b), unless the Commission grants ULH&P deviation. 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) 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 the transaction is not priced at CM&T s fully distributed cost because natural gas is a commodity and that CM&T is a marketer that sells gas at the market price. It also states that the transaction is not priced pursuant to ULH&P s existing SEC- and FERC-approved cost allocation methodologies because the methodologies do not apply to natural gas.[1]

ULH&P states that while in the past it has not entered into intermediate term firm supply contracts for its summer gas supply, it considered various market conditions and decided to enter into such contracts for the summer 2003. Therefore, in February 2003, ULH&P, along with Cincinnati Gas & Electric Company and Lawrenceburg Gas

[1] Application at 3.

Company,[2] issued a request for proposal (RFP) to 11 producers and marketers, including CM&T, seeking bids for its 2003 summer season gas supply for both base and swing load supply. ULH&P states that all of the potential suppliers submitted bids and that all of the bids included a reservation fee. ULH&P states that it believed it could purchase base gas month to month at the Inside FERC First of Month Index price with no premium so it decided to reject the bids.[3] On February 28, 2003, ULH&P sent letters to all the RFP respondents informing them that their bids had been rejected. ULH&P states that when it purchased natural gas for the month of April, it was required to pay a premium over the First of Month Index, which it believes was a clear indication that it would not be able to purchase gas month to month at a flat index price.

ULH&P states that, on April 15, 2003, CM&T notified ULH&P that it would supply gas for summer 2003 without a reservation fee. As a result of CM&T s offer, ULH&P telephoned five of the suppliers that had submitted bids in response to the RFP and requested that they update their bids. ULH&P states that each supplier confirmed that a reservation fee would be included for summer gas.

ULH&P contends that a deviation from KRS 278.2207 is in the public interest and should be granted. It states that, as a result of the competitive bidding process, it determined that all other suppliers would provide the supply at the same price and that the difference was in the reservation fee. It states that CM&T s offer to supply ULH&P

[2] ULH&P, Cincinnati Gas & Electric Company, and Lawrenceburg Gas Company are all regulated affiliate utilities of Cinergy Corp.

[3] ULH&P s Response to the Commission Staff s First Data Request dated April 16, 2001, Item 4.

summer gas at the same price as the other suppliers without a reservation fee will result in its customers experiencing significant savings.

The Commission, having considered the record and being otherwise sufficiently advised, finds that ULH&P s proposed 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. The Commission finds that the transaction was arm s length since ULH&P issued an RFP and consulted five of the suppliers again after it received its new offer from CM&T. The Commission further finds that this transaction is for summer supply only, April through October, and that the deviation should apply only to this transaction.

The Commission notes that in the report submitted by Liberty Consulting Group (Liberty) as a result of the management audit conducted in Administrative Case No. 384,[4] Liberty recommended that ULH&P increase its efforts to find additional gas suppliers. We agree that ULH&P should make every effort to increase the number of suppliers for its gas supply and that, in order to determine the reasonableness of the pricing from the suppliers, it should issue an RFP for its winter supply. The Commission further finds that the Attorney General s motion for intervention is authorized by statute and should be approved.

[4] Administrative Case No. 384, An Investigation of Increasing Wholesale Natural Gas Prices and the Impacts of Such Increases on the Retail Customers Served by Kentucky s Jurisdictional Natural Gas Distribution Companies (Orders dated January 30, 2001 and July 16, 2001).

The Commission further notes that ULH&P has requested expedited consideration for its proposal. Based on information provided by ULH&P in its responses to Commission Staff s First Data Request, it appears that ULH&P and CM&T finalized the terms and conditions of the purchase on April 18, 2003, 13 days before the application was filed. ULH&P is put on notice that time-sensitive applications must be filed as early as possible, not weeks after the major parameters of the transactions are known with reasonable certainty.

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 the supply of natural gas for the 2003 summer season (April through October) at the terms and prices set forth in the proceeding. ULH&P shall receive prior Commission approval for any changes.

4. ULH&P shall file, within 10 days of the execution, all documents associated with this transaction.

Done at Frankfort, Kentucky, this 23rd day of May, 2003.

By the Commission

ATTEST:

Wm H. Bowker

Deputy Executive Director