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 WINTER 2003-2004 NATURAL GAS PURCHASES FROM CINERGY MARKETING & TRADING, LP, AN AFFILIATE	)	CASE NO. 2003-00268

O R D E R

On July 10, 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 ULH&P to purchase natural gas from Cinergy Marketing & Trading, LP (CM&T), an affiliate, for winter 2003-2004. ULH&P further requests that the Commission render its decision by August 1, 2003.

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. The relationship between ULH&P and CM&T requires that the pricing for the proposed transaction comply with KRS 278.2207(1)(b), unless the Commission grants ULH&P a 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 CM&T, as a marketer, sells natural gas at the market price. The proposed transaction does not comply with the pricing requirements of the statute.

ULH&P states that, on June 3, 3003, it initiated a competitive bidding process to obtain its winter 2003-2004 gas supply. It states that its request for proposal requested bids on firm contracts for gas supply and for peaking service for ULH&P and its regulated affiliates, Cincinnati Gas & Electric Company and Lawrenceburg Gas Company, and was sent to 15 producers and marketers.[1] The respondents were asked to submit their bids for firm base load supply at the *Inside FERC First of Month Index* price and were requested to submit their bids for firm swing load supply at the *Gas Daily* midpoint price.

[1] ULH&P states that it combined the gas supply requirements for all three companies to obtain the most favorable prices.

In the report submitted by Liberty Consulting Group (Liberty) as a result of the Management Audit conducted in Administrative Case No. 384,[2] Liberty recommended that ULH&P increase its efforts to find additional gas suppliers.[3] ULH&P states that, in response to this recommendation, it is increasing its number of firm gas suppliers to six and requests the deviation to permit CM&T to be included as one of the six suppliers.

ULH&P reports that it received bids from 12 suppliers for firm gas supply and that each bid contained a reservation fee. It reports that only two suppliers, CM&T and Proliance, submitted bids for peaking service. It states that CM&T s bid contained the second lowest reservation fee for gas supply and the lowest reservation fee for peaking service. ULH&P asserts that the pricing is reasonable and that it is in the public interest to grant the deviation requested. It argues that if CM&T is excluded, the cost of the next-best solution would increase the total reservation fees it would be required to pay for firm supply by $12,000.

ULH&P states that CM&T has agreed to extend its offer through August 1, 2003. As a result, ULH&P requests that the Commission render its decision in this matter by that date. ULH&P states that if a ruling is not made by that date, it will be required to make alternative supply arrangements for its winter supply.

The Commission, having considered the record, including the bid information submitted, and being otherwise sufficiently advised, finds that ULH&P has

[2] 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.

[3] Final Report Audit of Five Major Kentucky Gas Local Distribution Companies at Page III.D.3.11.

demonstrated that the proposed transaction with CM&T is reasonable and further finds that ULH&P s request is in the public interest.

IT IS THEREFORE ORDERED that:

1. ULH&P s request to deviate from the provisions of KRS 278.2207(1)(b), as provided by KRS 278.2207(2), is granted.

2. This deviation applies only to the transaction described in this proceeding between ULH&P and CM&T for the winter 2003-2004.

Done at Frankfort, Kentucky, this 31st day of July, 2003.

By the Commission

ATTEST:

Wm H. Bowker

Deputy Executive Director