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), KRS 278.2207(2) AND KRS 278.2219 TO ALLOW IT TO ENTER INTO A NATURAL GAS ASSET MANAGEMENT AGREEMENT WITH CINERGY MARKETING & TRADING, LP, ITS AFFILIATE	))))))))	CASE NO. 2003-00348

O R D E R

On September 18, 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 gas supply manager.

BACKGROUND

On November 1, 2002, ULH&P entered into an agreement with CM&T which provided for CM&T to manage ULH&P s gas supply assets through October 31, 2003. ULH&P was granted a deviation from KRS 278.2207(1)(b) by the Commission for that transaction in Case No. 2003-00024[1] and was ordered to provide a comparison of the cost of gas obtained from CM&T to the index price of gas. ULH&P desires to enter into a new Asset Management Agreement with CM&T through October 31, 2004 and seeks

[1] Case No. 2003-00024, Application of The Union Light, Heat and Power Company for Deviation from the Requirements of KRS 278.2207(1)(b) (Order entered July 1, 2003).

permission from the Commission to deviate from KRS 278.2207(1)(b) for this transaction. No intervention requests have been received to date.

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.

ULH&P states that Cinergy Corp. s (Cinergy) Gas Commercial Operations issued a request for proposal (RFP) to 10 merchant companies for a New Asset Management Agreement covering the natural gas assets owned by ULH&P and Cinergy s affiliated local distribution companies, The Cincinnati Gas & Electric Company and Lawrenceburg Gas Company. ULH&P states that three companies responded to the RFP. It further states that the two highest bidders, Proliance Energy, LLC and CM&T, were notified of Cinergy s credit requirements. ULH&P states that CM&T was the only bidder that agreed to the credit requirements.

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 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 in essence there are two different commodity products that are provided under the Asset Management Agreement. ULH&P will purchase gas from CM&T, and CM&T will purchase ULH&P s interstate pipeline transportation capacity. It 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 its request for deviation is reasonable and should be granted. It states that it used a competitive bid process to obtain the highest possible asset management fee and that 100 percent of the fee will be flowed through to its ratepayers.

The Commission, having considered the record and being otherwise sufficiently advised, finds 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) is in the public interest and should be granted.

The Commission further finds that ULH&P should be required, as in the past, to provide the Commission with a report comparing the cost of the gas it obtains from CM&T to the gas indices and to include in the report an explanation of any differences in the costs. The filing of this report should again be dependent on ULH&P s future decisions regarding continuing its relationship with CM&T as its asset manager. If, through a competitive bidding process, ULH&P determines that CM&T should continue as the asset manager beyond the term of the Agreement outlined in this proceeding, ULH&P should file this comparison report with its next application seeking further deviation of KRS 278.2207(1)(b). If ULH&P does not plan to continue to retain CM&T as its asset manager after October 31, 2004, ULH&P should file this comparison with the Commission no later than November 15, 2004.

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 between ULH&P and CM&T for asset management services through October 31, 2004.

3. ULH&P shall file a report comparing the cost of gas obtained by ULH&P in the manner and by the dates described in this Order.

Done at Frankfort, Kentucky, this 20th day of October, 2003.

By the Commission

ATTEST:

Executive Director