

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 ALLOW IT TO ENTER) CASE NO. 2004-00363
INTO A NATURAL GAS ASSET)
MANAGEMENT AGREEMENT WITH)
CINERGY MARKETING& TRADING, LP, ITS)
AFFILIATE)

O R D E R

On September 13, 2004, 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

In 2003, ULH&P entered into an agreement with CM&T that provided for CM&T to manage ULH&P’s gas supply assets through October 31, 2004. ULH&P was granted a deviation from KRS 278.2207(1)(b) by the Commission for that transaction in Case No. 2003-00348.¹ ULH&P now requests that the Commission grant a deviation that would permit it to enter into a new Asset Management Agreement (“Agreement”) with

¹Case No. 2003-00348, Application of The Union Light, Heat and Power Company for Deviation from the Requirements of KRS 278.2207(1)(b), 278.2207(2) and 278.2219 to Allow It to Enter Into a Natural Gas Asset Management Agreement With Cinergy Marketing & Trading, LP, Its Affiliate.

CM&T that would extend through October 31, 2006. 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.

ULH&P states that Cinergy Corp.'s ("Cinergy") Gas Commercial Operations issued a request for proposal ("RFP") to 10 merchant companies seeking bids for the management of the natural gas assets owned by ULH&P and Cinergy's affiliated local distribution company, Cincinnati Gas & Electric Company. ULH&P states that five companies responded to the RFP and that CM&T was the highest bidder.

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 flow through to its ratepayers. It further states that the gas purchases made by ULH&P from CM&T, as provided in the Agreement, were appropriate and reasonable.

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 will 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. We find, however, that a few corrections should be made to the Agreement submitted by ULH&P on October 19, 2004 in response to Commission Staff’s first data request. We find that Article III, Paragraph B, should be changed to eliminate any reference to a customer choice program since ULH&P does not have an approved customer choice program. We also find that the reference to the Public Utilities Commission of Ohio in Article I and Article XVI of the Agreement should be amended to reference the Kentucky Public Service Commission.

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 explaining any differences in the costs. The filing of this report should again be dependent upon 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 along 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, 2006, ULH&P should file this comparison with the Commission no later than November 15, 2006.

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, 2006.
3. ULH&P shall file a report comparing the cost of gas obtained by ULH&P from CM&T in the manner and by the dates described in this Order.
4. ULH&P shall amend the language in the Agreement to reflect the Commission's findings herein.

Done at Frankfort, Kentucky, this 28th day of October, 2004.

By the Commission

ATTEST:

A handwritten signature in black ink, consisting of several overlapping loops and a long horizontal stroke at the end, positioned above a solid horizontal line.

Executive Director

Case No. 2004-00363