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The Public Utilities
Commission of Ohio

A report by the Staff of the
Public Utilities Commission of Ohio

Cincinnati Gas & Electric Company

Case No. 01-1228-GA-AIR
AMRP Annual Filing For
Calendar Year 2006

Case No. 01-1539-GA-AAM
AMRP Annual Filing For
Calendar Year 2006

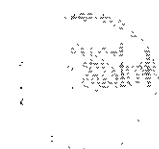
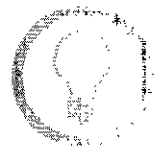
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REPORT
OF
INVESTIGATION

In the Matter of the Application of)	Case No. 01-1228-GA-AIR
The Cincinnati Gas & Electric Company)	AMRP Annual Filing For
For an Increase in Rates.)	Calendar Year 2006
In the Matter of the Application of)	Case No. 01-1539-GA-AAM
The Cincinnati Gas & Electric Company)	AMRP Annual Filing For
For Approval to Change Accounting Methods.)	Calendar Year 2006

Submitted
To
The Public Utilities Commission

BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of)	Case No. 01-1228-GA-AIR
The Cincinnati Gas & Electric Company)	AMRP Annual Filing For
For an Increase in Rates.)	Calendar Year 2006
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The Cincinnati Gas & Electric Company)	AMRP Annual Filing For
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Alan R. Schriber, Chairman
Ronda Hartman Fergus, Commissioner
Judith A. Jones, Commissioner
Donald L. Mason, Commissioner
Valerie A. Lemmie, Commissioner

To The Honorable Commission:

In accordance with the stipulation adopted, the Commission's Staff has conducted its investigation in the above referenced matter and hereby submits its findings in this report to the Commission.

The Commission's Utilities Department has prepared this report under the overall supervision of Steven R. Brennen. The Financial Review portion of the report was prepared under the supervision of Ed Hess and Ibrahim Soliman, and the Contractor Selection Process portion of the report was prepared under the supervision of Bob Fortney and Jeff DeVore.

In accordance with the Commission's Entry issued on December 7, 2006, copies of the report have been filed with the Docketing Division of the Commission. Interested parties are advised that written objections to the Cincinnati Gas & Electric Company (CG&E) application shall be docketed as soon as possible but no later than March 16, 2007, and in the event a hearing is necessary, the hearing will commence on April 4, 2007.

This report is intended to present for Commission consideration the results of the Staff's investigation. It does not purport to reflect the views of the Commission nor should any party to said proceeding consider the Commission as bound in any manner by the representations and/or recommendations set forth therein. The report, however, is legally cognizable evidence upon which the Commission may rely in reaching its decision in this matter. (See Lindsey, et. al. v. PUC, 111 O.S. 6)

Respectfully submitted,

Utilities Department



Steven R. Brennen
Director

BACKGROUND

The Cincinnati Gas & Electric Company (CG&E or Applicant) was incorporated in Ohio on April 3, 1897, as Cincinnati Gas, Light and Coke Company, and the name of Cincinnati Gas & Electric was adopted in 1901. Growth, acquisitions and mergers throughout the years have resulted in the present operation in which the Applicant renders electric or gas service, or both, in ten counties in Ohio. The Applicant is a public utility engaged in the business of distribution and sale of gas to approximately 400,000 customers located in eight counties in the southwest portion of Ohio.

On October 24, 1994, CG&E merged with PSI Resources, Inc., to form a new registered holding company, Cinergy Corporation. Prior to the merger, PSI Resources, Inc. was the parent company of PSI Energy, Inc., an electric utility serving Indiana. Following the merger, Cinergy Corporation, a Delaware corporation, became the parent holding company for CG&E and PSI Energy, Inc. With the merger, PSI Resources, Inc. ceased to exist.

On June 1, 2005, Cinergy Corporation and Deer Holding Corporation filed an application with the Commission requesting authorization to merge Cinergy Corporation and Duke Energy Corporation. With its application, the joint Applicants requested Commission approval to allow Deer Holding Corporation to acquire 100 percent of the stock of Cinergy Corporation. Deer Holding Corporation, a Delaware chartered holding company, was created by Duke Energy Corporation as a subsidiary solely for the purpose of owning Duke Energy and Cinergy as wholly-owned subsidiaries. Following the merger, Deer Holding Corporation's name was changed to Duke Energy Corporation and the entity previously known by the same name was renamed Duke Power Company, LLC. On December 21, 2005, The Commission approved the merger and the Applicant's name was changed to Duke Energy of Ohio.

On April 17, 2002, various parties entered into an agreement resolving all issues in the CG&E Case Nos. 01-1228-GA-AIR, 01-1478-GA-ALT, and 01-1539-GA-AAM. This Stipulation and Recommendation was approved by the Commission on May 30, 2002.

One resolved issue concerns the establishment of the Accelerated Main Replacement Program (AMRP) rider, where rates are established for each year and for each class of service through 2007, and that such rates established in 2007 would continue until the effective date of the rates set in the Applicant's next base rate case. The rider is designed to recover expenditures associated with the company's AMRP, which covers the ten-year replacement of all twelve inch and smaller cast iron and bare steel gas mains in its distribution system. The Staff, by way of an annual filing by CG&E for an increase in rates, would review the viability of such rates.

As a part of the annual filing, a pre-filing notice is to be issued in November of each year, and will consist of nine months of actual and three months of projected data for

the calendar year, or test year, with a date certain December 31. By February 28 of the following year, the Applicant will file an application updating to a full year of actual data.

The Commission's December 7, 2006 Entry stated that unless Staff finds CG&E's filing to be unjust or unreasonable, or if any other party files an objection that is not resolved by CG&E by March 23, 2007, the Staff will recommend Commission approval of the company's application, with the increase in the AMRP rider taking effect with the first billing cycle for the May revenue month.

On November 30, 2006, the Applicant filed in Case No. 01-1228-GA-AIR and 01-1539-GA-AAM a notice of intent to file an application for an increase in the AMRP rider rates, along with a motion to establish a test period of twelve months ending December 31, 2006, and the date certain of December 31, 2006. Also on this date, the Applicant filed schedules 1 through 18 demonstrating the justness and reasonableness of the requested revenue increase associated with the AMRP.

On February 27, 2007, the Applicant filed schedules 1 through 18 to update its application to a full year of actual data.

AMRP rider rates for 2007 are established pursuant to the Stipulation and Recommendation, and are capped at \$5.80 per month for residential consumers; \$30.44 per month for general service and firm transportation customers; and \$0.03 per Mcf, subject to a per-month cap of \$500, for interruptible transportation customers.

Scope of Staff's Investigation

The scope of the Staff's investigation was designed to determine if the Applicant's filed exhibits justify the reasonableness of the adjustment to their revenue requirement used as a basis for the annual increase to the AMRP rider. This report is to identify exceptions to the Applicant's rate filing, generally explain the basis or bases for each exception, and provide recommendations to correct those exceptions.

The Staff reviewed and analyzed all of the documentation filed by the Applicant and traced it to supporting work papers and to source data. As part of its review, the Staff issued data requests, conducted investigative interviews, and performed independent analyses when necessary.

When investigating the Applicant's operating income, the Staff limited its review to expenses associated with depreciation, amortization of post in-service carrying charges, meter relocations, customer owned service lines, property taxes, and maintenance savings.

For rate base, the Staff reviewed and tested the Applicant's plant accounting system to ascertain if the information on mains and services assets contained in the Applicant's plant ledgers and supporting continuing property records represented a reliable source of original cost data. The computation of the Allowance of Funds Used During Construction (AFUDC) was examined. The existence and the used and useful nature of these assets were verified through physical inspections. The testing included the selection of transactions for detailed review followed by the conducting of on-site inspections. Finally, the Staff reviewed post in-service carrying costs and its deferred income tax effect, and deferred taxes on liberalized depreciation.

The Staff also reviewed the bidding process by which contractors were selected to perform the mainline and service line replacement.

Contractor Selection Process

Duke Energy Ohio's (formerly The Cincinnati Gas & Electric Company's) accelerated main replacement program, AMRP, is the plan to ultimately replace 1200 miles of bare steel, cast iron, and ductile iron gas mains and also customer service lines. During 2006, the Company replaced 67.3 miles of main. The total gas main replaced through the end of 2006 is 529.3 miles.

Each year, the Company sets the capital budget for the following year's work. Depending on the specific makeup of the future year's work, the mileage and type of mains to be replaced as well as the cost varies. When these future years' jobs are bid out, the specifics are established in the pertinent contracts. Each contractor's success in completion of their work in a satisfactory manner and capability for increased assignments might result in the Company adjusting the next year's awarded amounts for that particular contractor should that contractor enter a successful bid in the ensuing year. The Company has a goal of dividing each year's work among at least five different contractors in order to ensure competitive prices in the future. For instance, there were nine contractors performing required AMRP work during 2006. The Company's practicable maximum number of contractors is ten, which is a manageable number from the standpoint of Company administration, training and record-keeping. The Company considers that each year's goals are met on a year-to-year basis as the contracted work is completed.

In its evaluation of the contractor selection process for this case, Staff reviewed copies of the latest Cast Iron Bare Steel (CIBS) bid selection analyses and summaries of the CIBS listings of expenditures, Contractor Bid Price and Work Order Estimates for 2006 Jobs by Contractor with comments on Contractor performance. Staff also reviewed summaries of the AMRP costs and work performed by the Contractor.

In the latest 2006 Stipulation and Recommendation, accepted by the Commission in its Fifth Opinion and Order in this case, April 19, 2006, the Company agreed, among other things, to competitively bid at least 80% of the work for the AMRP program, to use unit-based prices for the program with allowed exceptions, and to only award AMRP work to an affiliate if it was economic to do so.

Competitively Bid AMRP Work:

The Company competitively bid more than 97% of the AMRP work based on construction costs incurred through December 31, 2006.

Unit-based Pricing:

The Company agreed to manage AMRP construction costs through contracts that provide unit-based prices. There are four exceptions allowed in which construction

costs may exceed the contracted pricing: (1) unanticipated field conditions, (2) additional right-of-way work imposed by a government entity, (3) greater numbers of units required for the actual work versus the number contemplated in the plan drawings, and (4) certain types of construction activities wherein the company determines that the contractor could perform the work under other pricing methods such as on a time and materials basis. In the contractor and job reviews by the Staff, there were instances of overruns. The reasons for these overruns fall within the set of allowable exceptions.

Awarding AMRP work to an affiliate:

If AMRP work was awarded to an affiliate, the Company agreed to report the name of the contractor, the costs paid and the reason the work was awarded to the affiliate. At the time the 2006 AMRP contracts were awarded, Miller Pipeline was such an affiliate. The Company reports that for the 2006 AMRP program, the Company paid Miller Pipeline \$10,649.76 for AMRP work. The Company reports that this work was the result of the competitive bidding process and that Miller Pipeline was the lowest and best bidder. The Company reports that effective July 1, 2006 Duke Energy Ohio, Inc. sold its interest in Miller Pipeline Corporation to Vectren Corporation. Therefore, Miller Pipeline Corporation is no longer an affiliate of the Company.

The Company also reports that during a portion of 2006, Reliant Services, LLC, or Reliant, was an affiliate providing location services to the AMRP program. The Company states that Reliant provided these services at cost pursuant to the terms of the utility-non-utility service agreement as approved by the SEC, FERC, and the Commission. During the 2006 AMRP construction program, the Company paid Reliant \$19,272.50. Effective October 30, 2006, Central Locating Services began providing all locating services to the Company. Central Locating Services is not an affiliate.

Based upon review of Duke Energy Ohio, Inc.'s 2006 AMRP job determination, bidding and contracting procedures, job monitoring, and contracting controls, Staff finds that the current management operation and bidder selection and contractor oversight of the AMRP are reasonable.

Applicant's Proposed Recovery

The Applicant proposes a revenue requirement calculation, by class, with billing determinates in order to support the 2007 AMRP rider rates approved by the Commission in the Applicant's last base rate case. The effective date of such rates is the first billing cycle in May 2007.

The Applicant's calculation is supported on the basis of what was agreed upon in the Stipulation and Recommendation discussed above and includes the following:

- Original Cost and Accumulated Reserve for post-3/31/01 (date certain, Case No. 01-1228-GA-AIR) AMRP program property
 - Used and Useful on December 31, 2006
 - Capital expenditures for new plant (limited to new mains and services)
 - Adjustments for the retirement of existing assets
- Calculation of Post in Service Carrying Charges (PISCC) on net plant additions and related deferred taxes
 - Recorded in unique sub-accounts of Account 182.3, Other Regulatory Assets
 - Calculated from the date that the applicable assets are used and useful (post-3/31/01) until the next effective date of AMRP rider
 - Based on company's embedded interest cost and recorded at the gross rate for recovery on deferred taxes that lessens amount for recovery
- Calculation of deferred taxes on liberalized depreciation
- Proper annual depreciation expense
- Gross-up of 9.10% rate of return assigned to the recovery of all AMRP net capital expenditures
- Operation and maintenance expenses savings resulting from the AMRP
- Incremental property taxes associated with net plant additions
- Expenses associated with the cost of meter relocations and all customer owned service lines
- An AMRP revenue requirement that was allocated to each class based on the respective class' proportionate share of base revenues (not including gas costs and AMRP rider revenues) for each applicable test year set in the annual AMRP rider update

- Any annual over-recovery of the residential revenue requirement established in each annual proceeding.

The Applicant's AMRP revenue requirement of \$42,757,340 for AMRP net plant additions capitalized from the program's inception through date certain of December 31, 2006, is allocated to the rate classes using base revenue (excluding gas costs and AMRP revenue), the number of customer bills and Mcf sales for the twelve months that ended December, 2006. The residential service and residential firm transportation share of the revenue requirement is \$27,454,488, the general service and firm transportation share is \$12,134,533 and interruptible transportation share is \$3,168,319. Applying each revenue requirement number to its appropriate billing determinate generates the following rates:

<u>Class of Service</u>	<u>Calculated AMRP Rate</u>	<u>2006 AMRP Rate Cap</u>
Residential Service	\$ 5.86 / per month	\$ 5.80 / per month
General Service/Firm Transportation	\$ 32.88 / per month	\$ 30.44 / per month
Interruptible Transportation	\$ 0.18 / per Mcf	\$ 0.03 / per Mcf Subject to \$500 / Per month cap

Staff's Exceptions and Recommendations

The Staff has completed its investigation of the Applicant's proposed AMRP rider. As a result of its investigation, the Staff has determined that the Applicant's calculation of the AMRP revenue requirement as reflected in the updated filing is supported by adequate data and information and is just and reasonable. The Staff believes that the revenue requirement is properly allocated to the various customer classes, and the rate design is properly performed in accordance with the terms and conditions of the Stipulation and Recommendation. The Applicant's calculation of the AMRP rates for residential service, general service, and firm transportation all exceed the previously agreed to 2006 AMRP cap limits as set forth in the Stipulation. Since the Applicant's calculated rider rates for the three classes of services are above the agreed to cap limits, the Staff recommends only those rates permissible under the terms of the Stipulation and Recommendation. Therefore, the Staff recommends the approval of the 2006 AMRP rider rates of \$5.80 for residential service, \$30.44 for general service and firm transportation and \$0.03 per Mcf, subject to a per-month cap of \$500 for interruptible transportation, to be implemented in the first billing cycle of May 2007, or the first billing cycle of the month following the Commission's decision.

In addition, the Staff's investigation included a determination of any over-recovery of AMRP Rider residential revenues. In the Stipulation and Recommendation, dated April 17, 2002, the parties agreed that the Applicant would refund to residential customers any annual over-recovery of the residential revenue requirement established in each annual proceeding to be filed by the Applicant.

In its last AMRP annual proceeding, the Applicant's AMRP Rider reflected an annualized revenue requirement of \$32,279,413, of which \$22,281,965 was attributable to residential service. Such rider was to be in effect from May 2006 through April 2007.

As part of this year's proceeding, the Applicant provided the Staff with nine months actual AMRP Rider residential revenues collected for the period May 2006 through January 2007 and three months estimated revenues for the period February through April 2007 totaling \$22,565,893. This revenue collection results in an over-collection of \$283,928 from the revenue requirement of \$22,281,965 authorized by the Commission in the Applicant's last proceeding.

The Applicant's residential revenue requirement calculates a rate that is higher than the Stipulated 2007 AMRP rate cap (\$5.86 vs. \$5.80). An adjustment to reflect the over-collection of AMRP rider revenue of \$283,928 results in a residential AMRP rider rate of \$5.80, which is the same as the \$5.80 rate cap. As such, the \$5.80 rate cap for residential customers is just and reasonable.

