10

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

Staff Report of Investigation

In the Matter of the Application of	**]**	
The Cincinnati Gas & Electric Company	**]**	**Case No. 01-1228-GA-AIR**
For an Increase in Rates.	**]**	**AMRP Annual Filing**

In the Matter of the Application of	**]**	
The Cincinnati Gas & Electric Company	**]**	**Case No. 01-1539-GA-AAM**
For Approval to Change Accounting Methods.	**]**	**AMRP Annual Filing**

The Public Utilities Commission of Ohio
www.PUCO.ohio.gov • 1-800-686-PUCO
180 E. Broad Street Columbus, Ohio 43215

STAFF'S REPORT
OF
INVESTIGATION

In the Matter of the Application of	)	
The Cincinnati Gas & Electric Company	)	Case No. 01-1228-GA-AIR
For an Increase in Rates.	)	AMRP Annual Filing

In the Matter of the Application of	)	
The Cincinnati Gas & Electric Company	)	Case No. 01-1539-GA-AAM
For Approval to Change Accounting Methods.	)	AMRP Annual Filing

Submitted
to
The Public Utilities Commission

BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

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

Alan R. Schriber, Chairman
Ronda Hartman Fergus, Commissioner
Judith A. Jones, Commissioner
Donald L. Mason, Commissioner
Clarence D. Rogers, Commissioner

To The Honorable Commission:

In accordance with the provisions of R.C. Section 4909.19 and the stipulation adopted, the Commission's Staff has conducted its investigation in the above matter and hereby submits its findings in the within Staff Report.

The Commission's Utilities Department has prepared the Staff Report under the overall supervision of Steven R. Brennen. The Financial Review portion of the report was prepared under the supervision of Ibrahim S. Soliman, and the Contractor Selection Process portion of the report was prepared under the supervision of Stephen E. Puican.

In accordance with R.C. Section 4909.19, and the Commission's entry issued on March 11, 2003, copies of the Staff Report have been filed with the Docketing Division of the Commission. Interested parties are advised that written objections to the Cincinnati Gas & Electric Company's (CG&E) application shall be docketed as soon as possible but no later than April 1, 2003, and the hearing in these cases shall be scheduled to commence on April 14, 2003, if necessary.

The Staff Report is intended to present for the Commission's 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 or recommendations set forth therein. The Staff 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,

Christine M.T. Pirik
Chief of Staff

Utilities Department

Steven R. Brennen
Director

BACKGROUND

The Applicant, The Cincinnati Gas & Electric Company, (CG&E) was incorporated in Ohio on April 3, 1897, as Cincinnati Gas, Light and Coke Company, and its present name 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 section of Ohio.

On October 24, 1994, the Applicant merged with PSI Resources Inc. to form CINergy Corporation. CINergy is the parent company to both PSI Energy, Inc. (PSI Resources' utility subsidiary) and CG&E, and provides various services to both companies through its CINergy Services, Inc. subsidiary.

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 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 accelerated main replacement program, which covers the ten-year replacement of all cast iron and bare steel 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 at December 31. By February 28 of the following year, the Applicant will file an application updating to a full year of actual data.

The Stipulation and Recommendation stated that if the Staff's investigation of the filing is found to be just or reasonable, or that an objection from an intervening party was resolved by CG&E by April 1, 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 26, 2002, the Applicant filed in Case No. 02-3010-GA-AIR and 02-3011-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, 2002, and the date certain of December 31, 2002.

On December 4, 2002, the Applicant filed an amendment in Case Nos. 02-3010-GA-AIR and 02-3011-GA-AIR requesting that the notice of intent to file an application for an increase in the AMRP rider rates and the motion filed on November 26, 2002, be incorporated in Case Nos. 01-1228-GA-AIR and 01-1539-GA-AAM. The Applicant also requested that Case Nos. 02-3010-GA-AIR and 02-3011-GA-AAM be closed. By its Entry of December 19, 2002, the Commission approved these requests along with the requested date certain and test period. In this same entry, the Commission also stated that future requests for approval of the test year and date certain will not be necessary unless the Applicant seeks a different test year or date certain.

On December 24, 2002, the Applicant filed an application to increase the AMRP rider rates pursuant to the Stipulation and Recommendation.

On January 7, 2003, the Applicant filed the Direct Testimony of Lee T. Howe and Leonard C. Randolph, Jr., with Mr. Howe's testimony providing, in part, revisions to the gas maintenance accounts savings, property tax expense, and the pre-tax rate of return calculations.

On February 28, 2003, the Applicant filed an application updating to a full year of actual data, revised its methodology for calculating PISCC, and further revised its methodology for calculating property tax expense.

AMRP rider rates for 2003 were established pursuant to the Stipulation and Recommendation, and are capped at $2.00 per month for residential consumers; $10.43 per month for general service and firm transportation customers; and $0.02 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 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 cost and its deferred income tax effect.

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

Contractor Selection Process

The Accelerated Main Replacement Program will replace over 1400 miles of bare steel, cast iron, and ductile iron gas mains and customer service lines over a period of approximately 10 years. The 2001 AMRP modules were designed to replace the first 70 miles of cast iron and bare steel mains. These modules were, in effect, a "ramp-up" to the 150 miles of mains replacement per year that future year's construction will require. The 2001 process bid out the initial 70 miles of work which allowed CGE to become familiar with the contractors, their specialties, strengths and usual levels of costs. The scope of the work in 2001 also allowed the contractors to become familiar with the nature of some of the work such as service line replacement and customer in-house work. CGE chose the low bidders consistent with having enough contractors to perform the necessary work.

In 2002, miles of mains replaced increased to the annual target of 150. Contracts for the 2002 modules were negotiated with the 2001 contractors based upon known costs from the 2001 work and allowed for a profit of 8% over actual costs. Negotiating the construction modules was more efficient than re-bidding the new work. In the event that a module could not be negotiated, it would then be re-bid among the pool of contractors.

Staff believes that CGE's procedure for selecting contractors is reasonable to this point in time. Before the AMRP was begun, there was some concern that there may not be sufficient contractor resources available in the area to complete the ambitious replacement program. Contractor resources have not proven to be a problem thus far and the situation will continue to be monitored. Since the AMRP is a 10 year program, Staff will be reviewing how the construction contracts in succeeding years are let (ie. bid vs. negotiated). Future reviews of costs versus schedule will also be conducted.

Applicant's Proposed Recovery

The Applicant proposes a revenue requirement calculation, by class, with billing determinates in order to support the 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 2003.

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, 2002
  - Capital expenditures for new plant (limited to new mains and services)
  - Adjustments for the retirement of existing assets

- Calculation of 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

- 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 AMRP rider revenues) for each applicable test year set in the annual AMRP rider update

The Applicant calculates the revenue requirement for AMRP net plant additions capitalized from the program's inception through date certain of December 31, 2002, to be $12,919,231. This amount is identified by the rate classes of residential service and residential firm transportation for $8,281,227, general service and firm transportation for $3,587,670, and interruptible transportation for $1,050,334. Applying each revenue requirement number to its appropriate billing determinate generates rates of $1.84/per month, $9.84/per month, and $0.05/per Mcf respectively. This indicates rates for residential and general service falling well within the rate cap limits, and the rate for interruptible transportation far exceeding the rate cap limit. The interruptible transportation rate is limited to the agreed upon cap of $0.02/per Mcf, subject to a per-month cap of $500. Therefore, this will reduce the total estimated revenue requirement by $594,472 (19,815,723 Mcf x $0.03).

Staff's Exceptions and Recommendations

As a result of the Staff's investigation, the Applicant's updated AMRP revenue requirement reflects several corrections to the calculations of post in-service carrying cost and associated deferred taxes, the annualization of property tax, the reduction in maintenance expense, the amortization of post in-service carrying cost, and the gross-up of the 9.10% rate of return.

The Staff has determined that the calculation of the AMRP revenue requirement as reflected in the updated application is just and reasonable and recommends the approval of the 2003 AMRP rider rates of $1.84 for residential service and residential firm transportation, $9.84 for general service and firm transportation, and $0.02 per Mcf, subject to a per-month cap of $500 for interruptible transportation, to be implemented in the first billing cycle of May 2003, or the first billing cycle of the month following the Commission's decision.