

VECTREN CORP
Form 10-K
February 16, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2006

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number: **1-15467**

VECTREN CORPORATION

(Exact name of registrant as specified in its charter)

INDIANA

(State or other jurisdiction of incorporation or
organization)

One Vectren Square

(Address of principal executive offices)

35-2086905

(IRS Employer Identification No.)

47708

(Zip Code)

Registrant's telephone number, including area code: **812-491-4000**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class
Common - Without Par

Name of each exchange on which registered
New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: **NONE**

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of June 30, 2006, was \$2,056,925,411.

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

<u>Common Stock - Without Par</u>	<u>76,252,552</u>	<u>January 31, 2007</u>
<u>Value</u>		
Class	Number of Shares	Date

Documents Incorporated by Reference

Certain information in the Company's definitive Proxy Statement for the 2007 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A, not later than 120 days after the end of the fiscal year, is incorporated by reference in Part III of this Form 10-K.

Definitions

AFUDC: allowance for funds used during construction	MMBTU: millions of British thermal units
APB: Accounting Principles Board	MW: megawatts
EITF: Emerging Issues Task Force	MWh / GWh: megawatt hours / thousands of megawatt hours (gigawatt hours)
FASB: Financial Accounting Standards Board	NOx: nitrogen oxide
FERC: Federal Energy Regulatory Commission	OUC: Indiana Office of the Utility Consumer Counselor

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IDEM: Indiana Department of Environmental Management PUCO: Public Utilities Commission of Ohio

IURC: Indiana Utility Regulatory Commission SFAS: Statement of Financial Accounting Standards

MCF / BCF: thousands / billions of cubic feet USEPA: United States Environmental Protection Agency

MDth / MMDth: thousands / millions of dekatherms Throughput: combined gas sales and gas transportation volumes

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Access to Information

Vectren Corporation makes available all SEC filings and recent annual reports free of charge through its website at www.vectren.com, or by request, directed to Investor Relations at the mailing address, phone number, or email address that follows:

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Evansville, Indiana 47708

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PART I

ITEM 1. BUSINESS

Description of the Business

Vectren Corporation (the Company or Vectren), an Indiana corporation, is an energy holding company headquartered in Evansville, Indiana. The Company's wholly owned subsidiary, Vectren Utility Holdings, Inc. (Utility Holdings), serves as the intermediate holding company for three operating public utilities: Indiana Gas Company, Inc. (Indiana Gas), Southern Indiana Gas and Electric Company (SIGECO), and the Ohio operations. Utility Holdings also has other assets that provide information technology and other services to the three utilities. Utility Holdings' consolidated operations are collectively referred to as the Utility Group. Both Vectren and Utility Holdings were exempt from registration pursuant to Section 3(a) (1) and 3(c) of the Public Utility Holding Company Act of 1935, which was repealed effective February 8, 2006 by the Energy Policy Act of 2005 (Energy Act). Both Vectren and Utility Holdings are holding companies as defined by the Energy Act. Vectren was incorporated under the laws of Indiana on June 10, 1999.

Indiana Gas provides energy delivery services to approximately 565,000 natural gas customers located in central and southern Indiana. SIGECO provides energy delivery services to approximately 141,000 electric customers and approximately 112,000 gas customers located near Evansville in southwestern Indiana. SIGECO also owns and operates electric generation to serve its electric customers and optimizes those assets in the wholesale power market. Indiana Gas and SIGECO generally do business as Vectren Energy Delivery of Indiana. The Ohio operations provide energy delivery services to approximately 318,000 natural gas customers located near Dayton in west central Ohio. The Ohio operations are owned as a tenancy in common by Vectren Energy Delivery of Ohio, Inc. (VEDO), a wholly owned subsidiary of Utility Holdings (53% ownership), and Indiana Gas (47% ownership). The Ohio operations generally do business as Vectren Energy Delivery of Ohio.

The Company, through Vectren Enterprises, Inc. (Enterprises), is also involved in nonutility activities in three primary business areas: Energy Marketing and Services, Coal Mining and Energy Infrastructure Services. Energy Marketing and Services markets and supplies natural gas and provides energy management services. Coal Mining mines and sells coal. Energy Infrastructure Services provides underground construction and repair and energy performance contracting services. Enterprises also has other businesses that invest in energy-related opportunities and services, real estate, and leveraged leases, among other investments. In addition, the Company has investments that generate synfuel tax credits and processing fees relating to the production of coal-based synthetic fuels. These operations are collectively referred to as the Nonutility Group. Enterprises supports the Company's regulated utilities pursuant to service contracts by providing natural gas supply services, coal, infrastructure services, and other services.

Narrative Description of the Business

The Company segregates its operations into three groups: a Utility Group, a Nonutility Group, and Corporate and Other. At December 31, 2006, the Company had \$4.1 billion in total assets, with \$3.4 billion (84%) attributed to the Utility Group, \$0.6 billion (16%) attributed to the Nonutility Group, and less than \$0.1 billion attributed to Corporate and Other. Net income for the year ended December 31, 2006, was \$108.8 million, or \$1.44 per share of common stock, with \$91.4 million attributed to the Utility Group, \$18.1 million attributed to the Nonutility Group, and a net loss of \$0.7 million attributed to Corporate and Other. Net income for the year ended December 31, 2005, was \$136.8 million, or \$1.81 per share of common stock. For further information regarding the activities and assets of operating segments within these Groups, refer to Note 16 in the Company's consolidated financial statements included under "Item 8 Financial Statements and Supplementary Data."

Following is a more detailed description of the Utility Group and Nonutility Group. Corporate and Other operations are not significant.

Utility Group

The Utility Group is comprised of Utility Holdings' operations. The operations of the Utility Group consist of the Company's regulated operations and other operations that provide information technology and other support services to those regulated operations. The Company segregates its regulated operations into a Gas Utility Services operating segment and an Electric Utility Services operating segment. The Gas Utility Services segment includes the operations of Indiana Gas, the Ohio operations, and SIGECO's natural gas distribution business and provides natural gas distribution and transportation services to nearly two-thirds of Indiana and to west central Ohio. The Electric Utility Services segment includes the operations of SIGECO's electric transmission and distribution services, which provides electric distribution services primarily to southwestern Indiana, and includes the Company's power generating and asset optimization operations. In total, these regulated operations supply natural gas and/or electricity to over one million customers. The Utility Group's other operations are not significant.

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Gas Utility Services

At December 31, 2006, the Company supplied natural gas service to approximately 995,000 Indiana and Ohio customers, including 909,000 residential, 84,000 commercial, and 2,000 industrial and other contract customers. This represents customer base growth of 0.3% compared to 2005.

The Company's service area contains diversified manufacturing and agriculture-related enterprises. The principal industries served include automotive assembly, parts and accessories, feed, flour and grain processing, metal castings, aluminum products, appliance manufacturing, polycarbonate resin (Lexan®) and plastic products, gypsum products, electrical equipment, metal specialties, glass, steel finishing, pharmaceutical and nutritional products, gasoline and oil products, and coal mining. The largest Indiana communities served are Evansville, Muncie, Anderson, Lafayette, West Lafayette, Bloomington, Terre Haute, Marion, New Albany, Columbus, Jeffersonville, New Castle, Richmond, and suburban areas surrounding Indianapolis. The largest community served outside of Indiana is Dayton, Ohio.

Revenues

For the year ended December 31, 2006, gas utility revenues were approximately \$1,232.5 million, of which residential customers accounted for 66%, commercial 28%, and industrial and other contract customers 6%.

The Company receives gas revenues by selling gas directly to customers at approved rates or by transporting gas through its pipelines at approved rates to customers that have purchased gas directly from other producers, brokers, or marketers. Total volumes of gas provided to both sales and transportation customers (throughput) were 182.6 MMDth for the year ended December 31, 2006. Gas transported or sold to residential and commercial customers was 97.7 MMDth representing 53% of throughput. Gas transported or sold to industrial and other contract customers was 84.9 MMDth representing 47% of throughput. Rates for transporting gas generally provide for the same margins earned by selling gas under applicable sales tariffs.

The sale of gas is seasonal and strongly affected by variations in weather conditions. To mitigate seasonal demand, the Company has storage capacity at seven active underground gas storage fields and six liquefied petroleum air-gas manufacturing plants. The Company also contracts with its affiliate, ProLiance Energy, LLC (ProLiance), and with other third party gas service providers to ensure availability of gas. ProLiance is an unconsolidated, nonutility, energy marketing affiliate of Vectren and Citizens Gas and Coke Utility (Citizens Gas). (See the discussion of Energy Marketing & Services below and Note 3 in the Company's consolidated financial statements included in "Item 8 Financial Statements and Supplementary Data" regarding transactions with ProLiance). Periodically, purchased natural gas is injected into storage. The injected gas is then available to supplement contracted and manufactured volumes during periods of peak requirements. In lieu of storage, the Company prepays ProLiance for natural gas delivery services during the seven months prior to the peak heating season. The volumes of gas per day that can be delivered during peak demand periods for each utility are located in "Item 2 Properties."

Gas Purchases

In 2006, the Company purchased 95,561 MDth volumes of gas at an average cost of \$8.64 per Dth, of which approximately 72% was purchased from ProLiance and 28% was purchased from other third party providers. Vectren received regulatory approval on April 25, 2006 from the IURC for ProLiance to provide natural gas supply services to the Company's Indiana utilities through March 2011. As a result of the June 2005 PUCO order, the Company has established an annual bidding process for VEDO's gas supply and portfolio administration services. Since November 1, 2005, the Company has used a third party provider for these services. Prior to October 31, 2005, ProLiance supplied natural gas to all of the Company's regulated gas utilities. The average cost of gas per Dth purchased for the previous five years was \$8.64 in 2006; \$9.05 in 2005; \$6.92 in 2004; \$6.36 in 2003; and \$4.57 in 2002.

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At December 31, 2006, the Company supplied electric service to approximately 141,000 Indiana customers, including 122,000 residential, 18,800 commercial, and 200 industrial and other customers. This represents customer base growth of 1% compared to 2005. In addition, the Company has firm power commitments to four municipalities and has contingency reserve requirements consistent with Reliability First Corp. standards.

The principal industries served include polycarbonate resin (Lexan®) and plastic products, aluminum smelting and recycling, aluminum sheet products, automotive assembly, steel finishing, appliance manufacturing, pharmaceutical and nutritional products, automotive glass, gasoline and oil products, and coal mining.

Revenues

For the year ended December 31, 2006, retail and firm wholesale electricity sales totaled 6,004.5 GWh, resulting in revenues of approximately \$392.5 million. Residential customers accounted for 25% of 2006 revenues; commercial 22%; industrial 43%; and municipal and other 10%. In addition, the Company sold 898.3 GWh through optimization activities in 2006, generating revenue, net of purchased power costs, of \$29.7 million.

Generating Capacity

Installed generating capacity as of December 31, 2006, was rated at 1301 MW. Coal-fired generating units provide 1,006 MW of capacity, and natural gas or oil-fired turbines used for peaking or emergency conditions provide 295 MW.

In addition to its generating capacity, in 2006, the Company had 34 MW available under firm contracts and 62 MW available under interruptible contracts. The Company also had a firm purchase supply contract for a maximum of 73 MW for the cooling season months during 2006. This contract ended at the end of September 2006. Also, under the terms of the consent decree between SIGECO, the Department of Justice and USEPA, the Company discontinued operations of Culley Unit 1 (50 MW) effective December 31, 2006. The Company executed a capacity contract for a maximum of 100 MW for the years 2007-2009.

The Company has interconnections with Louisville Gas and Electric Company, Cinergy Services, Inc., Indianapolis Power & Light Company, Hoosier Energy Rural Electric Cooperative, Inc., Big Rivers Electric Corporation, and the City of Jasper, Indiana, providing the historic ability to simultaneously interchange approximately 500 MW. However, the ability of the Company to effectively utilize the electric transmission grid in order to achieve its desired import/export capability has been, and may continue to be, impacted as a result of the ongoing changes in the operation of the midwestern transmission grid. The Company, as a member of the Midwest Independent System Operator (MISO), has turned over operational control of the interchange facilities and its own transmission assets, like many other Midwestern electric utilities, to MISO. See “Item 7 Management’s Discussion and Analysis of Results of Operations and Financial Condition” regarding the Company’s participation in MISO.

Total load for each of the years 2002 through 2006 at the time of the system summer peak, and the related reserve margin, is presented below in MW.

Date of summer peak load	8/10/2006	7/25/2005	7/13/2004	8/27/2003	8/5/2002
Total load at peak ⁽¹⁾	1,325	1,315	1,222	1,272	1,258
Generating capability	1,351	1,351	1,351	1,351	1,351
Firm purchase supply	107	107	105	32	82

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Interruptible contracts	62	76	51	95	95
Total power supply capacity	1,520	1,534	1,507	1,478	1,528
Reserve margin at peak	15%	17%	23%	16%	21%

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⁽¹⁾ The total load at peak is increased 25 MW in 2006, 2005, 2003, and 2002 from the total load actually experienced. The additional 25 MW represents load that would have been incurred if Summer Cyclor program had not been activated. The 25 MW is also included in the interruptible contract portion of the Company's total power supply capacity in those years. On the date of peak in 2004, Summer Cyclor program was not activated.

The winter peak load for the 2005-2006 season of approximately 935 MW occurred on December 20, 2005. The prior year winter peak load was approximately 932 MW, occurring on January 18, 2005.

The Company maintains a 1.5% interest in the Ohio Valley Electric Corporation (OVEC). The OVEC is comprised of several electric utility companies, including SIGECO, and supplies power requirements to the United States Department of Energy's (DOE) uranium enrichment plant near Portsmouth, Ohio. The participating companies are entitled to receive from OVEC, and are obligated to pay for, any available power in excess of the DOE contract demand. At the present time, the DOE contract demand is essentially zero. Because of this decreased demand, the Company's 1.5% interest in the OVEC makes available approximately 34 MW of capacity for use in other operations. Such generating capacity is included in firm purchase supply in the chart above.

Fuel Costs and Purchased Power

Electric generation for 2006 was fueled by coal (98%) and natural gas (2%). Oil was used only for testing of gas/oil-fired peaking units.

There are substantial coal reserves in the southern Indiana area, and coal for coal-fired generating stations has been supplied from operators of nearby Indiana coal mines, including those owned by Vectren Fuels, Inc., a wholly owned subsidiary of the Company. Approximately 3.5 million tons of coal were purchased for generating electricity during 2006, of which approximately 91% was supplied by Vectren Fuels, Inc. from its mines and third party purchases. The average cost of coal consumed in generating electric energy for the years 2002 through 2006 follows:

Avg. Cost Per Ton	Year Ended December 31,				
	2006	2005	2004	2003	2002