Duke Energy

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VIA OVERNIGHT DELIVERY

January 16, 2013

Mr. Jeff Derouen
Executive Director
Kentucky Public Service Commission
211 Sower Blvd
Frankfort, KY 40601

Re: Case No. 2012-575
In the Matter of the Application of Duke Energy Kentucky, Inc. for an Order Authorizing the Issuance of Unsecured Debt and Long-Term Notes, Execution and Delivery of Long-Term Loan Agreements, and Use of Interest Rate Management Instrument

Dear Mr. Derouen:

Enclosed please find an original and twelve copies of *Duke Energy Kentucky, Inc.'s Responses to Commission Staff's First Set of Data Requests* in the above captioned case.

Please date-stamp the extra two copies of the filing and return to me in the enclosed envelope.

Sincerely,

Kristen Cocanougher

Kristen Cocanougher

cc: Dennis Howard II (w/enclosures)

450140

VERIFICATION

State of North Carolina)
) SS:
County of Mecklenburg)

The undersigned, Bryan Buckler, being duly sworn, deposes and says that he is the Director of Corporate Finance, that he has supervised the preparation of the responses to the foregoing information requests; and that the matters set forth in the foregoing responses to information requests are true and accurate to the best of his knowledge, information and belief, after reasonable inquiry.

Bryan Buckler
Bryan Buckler, Affiant

Subscribed and sworn to before me by Bryan Buckler on this 14 day of January 2013.

Katie Jamieson
NOTARY PUBLIC

My Commission Expires: June 14, 2016

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Duke Energy Kentucky
Case No. 2012-575
Staff First Set Data Requests
Date Received: January 10, 2013

STAFF-DR-01-001

REQUEST:

Clarify whether Duke Kentucky is requesting Commission approval to issue up to a total of $150 million in debt or up to a total of $176.72 million in debt.

RESPONSE:

Duke Kentucky is requesting approval to issue up to $150 million of new long term debt. Additionally, Duke Kentucky is requesting approval to have the flexibility to refinance existing tax-exempt bonds of $26.72 million for a total of $176.72 million of possible debt issuances.

In November 2010, the $26.72 million Duke Kentucky Pollution Control Revenue and Refunding Bonds were remarketed as Series 2010 ("Series 2010 Bonds"). In January 2012, the Series 2010 Bonds were remarketed to continue the bonds as variable-rate demand bonds supported by an irrevocable direct pay letter of credit, with such new letter of credit supporting the bonds issued by the New York Branch of Sumitomo Mitsui Banking Corporation. The letter of credit expires January 27, 2014. According to the terms of the Series 2010 Bonds, Duke Kentucky will be subject to a mandatory tender of the outstanding bonds at the expiration date of the letter of credit and since the bonds are long-term in nature with a final maturity of August 1, 2027, Duke Kentucky will evaluate refunding options (i.e., fixed-rate term bonds or variable-rate demand bonds), prior to the January 27, 2014 expiration date and take into account market conditions that could result in the bonds being put to us in the future. From a historical perspective, the tax-exempt market has continued to remain wide compared to historical levels (i.e., indicative rates for tax-exempt financing are very similar to taxable financing rates). While Duke Kentucky continues to evaluate plans to refund and reissue the $26.72 million variable rate tax-exempt bonds, the timing of such refinancing activities is uncertain and subject to market conditions.

PERSON RESPONSIBLE:

Bryan Buckler

STAFF-DR-01-002

REQUEST:

In Case No. 2010-00369,[1] Duke Kentucky requested approval to issue up to $100 million of long-term debt, and in the present case it appears Duke Kentucky is requesting approval to issue up to $150 million of long-term debt. Provide a detailed explanation supporting the additional $50 million of long-term debt requested in this proceeding"

RESPONSE:

Since our request in Case No. 2010-00369, environmental regulations have continued to be emphasized at both the state and national levels. Given the uncertainty around timing and scope of final regulations we are requesting an additional $50 million of authority in order to be able to react and begin the projects which may be needed to comply with these rules. Please see Staff-DR-01-007 for additional information regarding our capital expenditure projections.

PERSON RESPONSIBLE:

Bryan Buckler

[1] Case No. 2010-00369, Application of Duke Energy Kentucky, Inc. for an Order Authorizing the Issuance of Unsecured Debt and Long-Term Notes, Execution and Delivery of Long-Term Loan Agreements, and Use of Interest Rate Management Instruments (Ky. PSC Nov 10, 2010).

Duke Energy Kentucky
Case No. 2012-575
Staff First Set Data Requests
Date Received: January 10, 2013

STAFF-DR-01-003

REQUEST:

Refer to page 2 of the application, the request to borrow up to a maximum of $26.72 million from Boone County Kentucky, or another authorized issuer of tax exempt bonds. State whether the authorization sought in this case, as described at page 2 of the application, is identical to that authorized by the Commission in Case No. 2010-00369,[1] with the exception being the extension to December 31, 2014. If not, explain any other differences.

RESPONSE:

The authorization requested in this case is identical to what the Commission authorized in Case No. 2010-00369 except for extending the time to complete the transactions through December 31, 2014. Please see response to Staff-DR-01-001 for additional information.

PERSON RESPONSIBLE:

Bryan Buckler

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[1] Id.

Duke Energy Kentucky
Case No. 2012-575
Staff First Set Data Requests
Date Received: January 10, 2013

STAFF-DR-01-004

REQUEST:

Refer to numbered paragraph 5, page 3 of the application, the request to issue secured or unsecured debt or any combination thereof.

a. Explain how Duke Kentucky will determine whether to issue secured or unsecured debt and how much of each to issue.

b. Provide an estimate of the difference between secured and unsecured debt as it pertains to this specific financing request.

RESPONSE:

a. Depending on market conditions, secured debt is generally issued at a more favorable interest rate than unsecured debt due to the security of the credit enhancement. Duke Kentucky does not currently have an active First Mortgage Bond Indenture, therefore any secured debt issuance will require the creation of a mortgage indenture. In addition, secured debt tends to give rise to greater administrative and compliance requirements. At time of issue, Duke Kentucky will consider the costs and benefits associated with secured versus unsecured debt and select the overall most cost effective method of raising debt financing.

b. Under current market conditions, the interest rate cost difference between issuing secured debt versus unsecured debt is estimated to be approximately 10 - 20 basis points (approximately $75,000 impact to annual interest expense based on a $50 million debt issuance). Given that Duke Kentucky does not currently have any secured debt outstanding, this interest rate differential may be reduced by enhancing the unsecured debt covenants (i.e., include negative pledge covenant, which generally would attach an encumbrance to Duke Kentucky's assets if a future debt issuance included such security), as was done for the $100 million of 4.65% Debentures issued September 17, 2009. In addition, issuing unsecured debt avoids the costs associated with the creation of a mortgage indenture and the added administrative costs associated with managing mortgage indenture compliance.

PERSON RESPONSIBLE:

Bryan Buckler

Duke Energy Kentucky
Case No. 2012-575
Staff First Set Data Requests
Date Received: January 10, 2013

STAFF-DR-01-005

REQUEST:

Refer to page 7 of the Application, Use of Interest Rate Management Techniques. Duke Kentucky requests that the Commission grant Duke Kentucky authority to manage its overall effective interest cost. Duke Kentucky states the authority to continue to utilize interest-rate management techniques and enter into interest-rate management agreements will allow it sufficient alternatives and flexibility when striving to better manage its interest cost.

a. Explain whether this is the same "Use of Interest Rate Management Techniques" for which Duke Kentucky requested and received Commission approval for in Case No. 2010-00369.[1]

b. Provide a detailed explanation of Duke Kentucky's interest-rate management techniques along with all associated costs since the Commission's approval in Case No. 2010-00369.[2]

c. Provide a detailed analysis showing estimated interest cost savings the Company and its ratepayers realized as a result of Duke Kentucky's use of interest-rate management techniques.

RESPONSE:

a. Yes, Duke Kentucky's "Use of Interest Rate Management Techniques" is unchanged.

b. There have been no changes in Duke Kentucky's interest rate management techniques and associated costs since the Commission's previous approval. There has been no new interest rate management activity by Duke Kentucky since the Commission's previous approval.

c. There has been no new interest rate management activity by Duke Kentucky or any associated costs since the Commission's previous approval. An interest rate swap executed on August 2, 2006 continues to be in place. Execution of this swap reduced the floating rate exposure for Duke Kentucky below the 25% internal guideline thus limiting

[1] Id.
[2] Id.

exposure to interest rate volatility. As of December 31, the impact of the swap on Duke Kentucky's debt cost has been to increase cost by a cumulative amount of $4.1 million since the swap was originated in 2006 (i.e., less than $1 million annually on average).

PERSON RESPONSIBLE:

Bryan Buckler

Duke Energy Kentucky
Case No. 2012-575
Staff First Set Data Requests
Date Received: January 10, 2013

STAFF-DR-01-006

REQUEST:

Refer to page 9 of the Application, Request for Commission Approval and Conversion of Short-Term Loans Under Utility Money Pool Agreement. Provide an example of the analysis Duke Kentucky would expect to perform to evaluate if it is prudent for Duke Kentucky to convert borrowings under its revolving credit facility or the Utility Money Pool Agreement to long-term debt.

RESPONSE:

In general, the analysis of whether to convert short-term borrowings under either our utility money pool or revolving credit agreements to long-term primarily revolves around the permanence of the outstanding balance. Short-term borrowings, whether under the Utility Money Pool or the revolving credit facility, are generally used as a means to manage the company's working capital needs and provide low-cost flexibility to meet short-term cash short falls that may arise due to timing differences from the conversion of current assets, such as accounts receivables and inventory, into cash inflows. Additionally, short-term borrowings may be used as a temporary bridge to fund capital expenditures until the level of such borrowings justifies a long-term debt issuance. Once it is determined that short-term borrowings are a permanent part of our capital structure and therefore taking up a portion of our financial flexibility and liquidity, we proceed with issuing long-term debt. The conversion to long-term relieves the pressure on our available short-term funding capacity and liquidity. We may also pre-fund a certain amount of our expected financing needs which are anticipated to be a permanent layer of borrowings. Our analysis would depend on modeling the anticipated operating and capital cash flows of Duke Kentucky to understand its financing requirements. If financing gaps are short-term in nature then the utility money pool or revolving credit facility would be used, and if the financing gap is long-term then we would go to the capital markets to issue long-term debt.

PERSON RESPONSIBLE:

Bryan Buckler

Duke Energy Kentucky
Case No. 2012-575
Staff First Set Data Requests
Date Received: January 10, 2013

STAFF-DR-01-007

REQUEST:

Refer to Exhibit C of the application, which shows projected Capital Expenditures for the period 2012 through 2014.

a. Under the "Expansion" heading, explain the relatively high level of Smart Grid expenditures projected for 2014 as compared to 2012 and 2013. Provide all underlying assumptions and calculations used in producing the $1 7.8 million estimate.

b. Explain why items classified as "Maintenance" are included in projections of capital expenditures.

c. Under the "Maintenance" heading, clarify whether there are items of non-regulated operations included in projected capital expenditures, and explain what capital expenditures are included in the Regulated Operations line.

d. Under the "Maintenance" heading, explain what is included in the projected capital expenditures for Power and Gas Delivery, Customer Service, and Other FE&G.

e. Under the "Environmental" heading, explain the relatively high level of Environmental Control expenditures projected for 2014 as compared to 2012 and 2013. Provide all underlying assumptions and calculations used in producing the $31.9 million estimate.

RESPONSE:

a. In 2013, Duke Kentucky is assumed to only receive a very minor allocation of Information Technology (IT) and Project Management Office (PMO) capital Duke Energy is spending to support all of its Smart Grid programs. In 2014, the forecast is for Duke Kentucky to start a scaled deployment of Smart Grid Meter technology including smart meters, communication nodes and distribution automation. The capital spending assumptions are for planning purposes and scaled deployment would be discussed with and requested for approval by the Commission prior to actual deployment.

The $17.8 million in 2014 consists of $11 million for electric and gas meters, $3 million for communication nodes, $3 million in distribution automation, and $0.8 million of IT and PMO allocated capital.

b. In order to ensure the plants are available as needed to meet load requirements and the energy delivery and transmission system are reliable a certain amount of Duke Kentucky's capital expenditures are use to maintain the generation, delivery and transmission assets. Maintenance capital can be generally defined as maintenance expenditures that extend the useful life or increase the expected output or usefulness of the underlying asset. Therefore, Duke Kentucky's forecasted capital expenditures include the capital maintenance category. Please see items c and d below for additional information.

c. There are no non-regulated operations items included in projected capital expenditures.

   The capital expenditures included in the Regulated Operations line represent major maintenance projects on Duke Kentucky's generation plants. Generation plants require annual capital maintenance to ensure the plants are available as needed to meet the native load requirements.

d. Power and Gas Delivery includes estimates of capital related to transmission line and station maintenance, distribution substation maintenance and improvements, and Gas main and service line maintenance. Capital in this category supports power and gas delivery reliability and integrity standards.

e. Forecasted environmental and new resources capital expenditures includes estimates of capital related to replacing capacity assumed to be retired to meet certain existing proposed air, water and waste rules. The assumption is that $22 million of capital will be spent on the new 140MW gas combined cycle resource in 2014 (as discussed in the "Duke Energy Kentucky 2011 Integrated Resource Plan" filed on July 1, 2011) and $9 million on air, waste and water technology including $2.5 million for sorbent injection, $3 million for dry bottom ash collection and $3.4 million for a water treatment station. Duke Kentucky is still analyzing the least cost and most reliable alternatives and as the air waste and water rules are finalized, the plans will be adjusted to reflect the selected project for meeting the requirements of the final rules.

PERSON RESPONSIBLE:

Bryan Buckler

Duke Energy Kentucky
Case No. 2012-575
Staff First Set Data Requests
Date Received: January 10, 2013

STAFF-DR-01-008

REQUEST:

Refer to numbered paragraph 2, page 3 of the application. Duke Kentucky states that a certified copy of its Articles of Incorporation, as amended, is on file in Case No. 2009-00202.[1] The record in Case No. 2009-00202 contains a copy of the May 7, 1976 Restated Articles of Incorporation of The Union Light, Heat and Power Company ("Restated Articles"). The online records of the office of the Kentucky Secretary of State reflect that the May 7, 1976 Restated Articles contain a page with a Fifth, Sixth, and Seventh Article. The page containing the Fifth, Sixth, and Seventh Article does not appear to be located in the record of Case No. 2009-00202.

a. Confirm whether the entire Restated Articles are filed in Case No. 2009-00202.

b. If not, provide a certified copy of the May 7, 1976 Restated Articles.

RESPONSE:

a. There is an error in Case No. 2009-00202 and it does not contain the entire Articles of Incorporation.

b. A complete copy of the Articles of Incorporation can be found in Exhibit G in Case No. 2011-124:
http://psc.ky.gov/PSCSCF/2011%20cases/2011-0124/20110404_Duke_Application_Volume_3_of_4.pdf

PERSON RESPONSIBLE: Legal

[1] Case No. 2009-00202, Application of Duke Energy Kentucky, Inc., for an Adjustment of Rates (Ky. PSC Dec 29, 2009).