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August 19, 2011

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*Via Hand-Delivery*

Mr. Jeffrey Derouen  
Executive Director  
Kentucky Public Service Commission  
211 Sower Boulevard  
P. O. Box 615  
Frankfort, Kentucky 40602-0615

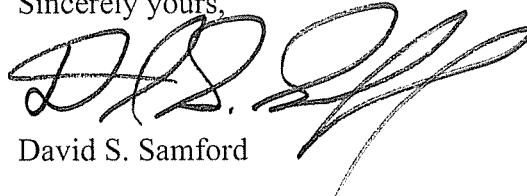
Re: In the Matter of: The Joint Application of Duke Energy Corporation,  
Cinergy Corp., Duke Energy Ohio, Inc., Duke Energy Kentucky, Inc.,  
Diamond Acquisition Corporation, and Progress Energy, Inc., for  
Approval of the Indirect Transfer of Control of Duke Energy Kentucky, Inc.  
PSC Case No. 2011-00124

Dear Mr. Derouen:

Please find enclosed an original and ten (10) copies of Joint Applicants' Petition for Rehearing in the above-styled action. Please file these documents in the record and return a file-stamped copy to me.

Please do not hesitate to contact me if you have any questions concerning this filing.

Sincerely yours,



David S. Samford

Enclosures

cc: Dennis G. Howard, II  
Lawrence Cook

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COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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AUG 19 2011

PUBLIC SERVICE  
COMMISSION

IN THE MATTER OF:

THE JOINT APPLICATION OF DUKE ENERGY )  
CORPORATION, CINERGY CORP., DUKE )  
ENERGY OHIO, INC., DUKE ENERGY )  
KENTUCKY, INC., DIAMOND ACQUISITION )  
CORPORATION, AND PROGRESS ENERGY, INC. )  
FOR APPROVAL OF THE INDIRECT TRANSFER )  
OF CONTROL OF DUKE ENERGY KENTUCKY, INC. )

CASE NO. 2011-00124

JOINT APPLICANTS' PETITION FOR REHEARING

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Come now Duke Energy Corporation ("Duke Energy" or the "Company"), Cinergy Corp. ("Cinergy"), Duke Energy Ohio, Inc. ("Duke Energy Ohio"), Duke Energy Kentucky, Inc. ("Duke Energy Kentucky"), Diamond Acquisition Corporation ("Diamond"), and Progress Energy, Inc. ("Progress Energy") (collectively "Joint Applicants"), pursuant to KRS 278.400 and 807 KAR 5:001, and apply to the Kentucky Public Service Commission ("Commission") for an Order granting rehearing for the limited purposes of revising and clarifying proposed regulatory Commitment 48 as set forth in the Commission's August 2, 2011 Order ("Commitment 48"). The Joint Applicants respectfully request the Commission to act upon the Petition for Rehearing as expeditiously as the Commission's schedule permits.

**I. Introduction**

Commitment 48 imposes a mandate that, following the merger of the two companies, the new Duke Energy Board of Directors include at least one non-employee director who is a customer of one of Duke Energy's Midwest operating companies. The underlying objective sought to be achieved by the Commission is shared by Joint Applicants and is one which has

historically been achieved without regulatory requirement. For example, the current Duke Energy Board includes Michael Browning, who is a resident of Indiana, and until his retirement at the May 2010 Annual Meeting of Shareholders, also included Dudley Taft, who is a resident of Ohio.

In its current form, however, Commitment 48 significantly complicates the merger transaction, could cause unnecessary disruption to the corporate governance of Duke Energy, and could result in an unintended default. Although Commitment 48 is similar to prior regulatory commitments imposing pre-qualifications on directors, it goes significantly further in several crucial aspects. The Joint Applicants hope that through the rehearing process, Commitment 48 can be appropriately revised so that the Commission's expectations are satisfied, the merger is completed in a timely manner, no disruption to Duke Energy's governance structure occurs, Commission precedent remains consistent and, most importantly, Duke Energy Kentucky's customers continue to enjoy access to safe, reliable and affordable electric and natural gas service. The Joint Applicants respectfully thank the Commission, Staff and Attorney General in advance for their consideration of this petition for rehearing and desire the opportunity to resolve this single remaining issue in a manner that is mutually acceptable to all.

## **II. Background**

This case presents the fourth major consolidation transaction in the history of Duke Energy Kentucky. In 1942, its predecessor, The Union Light, Heat and Power Company ("ULH&P") was acquired by The Cincinnati Gas & Electric Company ("CG&E"). In 1994, CG&E joined with PSI Resources, Inc. to form Cinergy and, most recently, in 2006, Cinergy and Duke Energy merged. Through each of these acquisitions, the customers of Duke Energy Kentucky have continued to enjoy safe, reliable and affordable electric and natural gas service.

Duke Energy Kentucky and its corporate parents also accepted a fair number of regulatory commitments associated with these transactions. With respect to the transaction at issue, the Joint Applicants voluntarily accepted forty-one of the forty-six regulatory commitments that were imposed as part of the Duke Energy/Cinergy merger, and provided an explanation as to why the remaining five legacy commitments were no longer relevant as part of the Application and direct testimony filed on April 4, 2011. In the course of responding to information requests and discussions at informal conferences, the Joint Applicants agreed to two additional regulatory commitments, as well as to certain modifications to other commitments. All of these regulatory commitments were included in the Stipulation and Settlement Agreement entered into between the Joint Applicants and the Attorney General and filed on June 24, 2011.

On August 2, 2011, the Commission issued its order conditionally approving the proposed merger transaction, provided that the Company would also accept three additional commitments and modifications to two other previously agreed-to commitments.<sup>1</sup> The Joint Applicants accept the modifications to existing commitments proposed by the Commission and also accept the two new commitments (Commitment 47 and Commitment 49) imposed upon the transaction.

With regard to Commitment 48, however, the Joint Applicants by this petition seek to explain the complications it poses in current form and respectfully suggest modifications that might be acceptable to the Commission. Commitment 48 states:

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<sup>1</sup> The Joint Applicants acknowledge that KRS 278.020(6) expressly authorizes the Commission to approve this transaction “upon terms and conditions as it deems necessary and appropriate.” The Joint Applicants also recognize the plenary nature of the Commission’s general authority arising under its exclusive jurisdiction to regulate the rates and services of utilities under KRS 278.040(2) and cases construing that authority in this context. *See e.g. Public Service Commission v. Cities of Southgate and Highland Heights*, 268 S.W.2d 19 (Ky.1954). According to KRS 278.410(1), the Commission’s authority is limited only to the extent that its exercise of that authority is unlawful or unreasonable. This petition focuses upon the reasonableness of Commitment 48 as applied to the corporate governance issues raised.

Joint Applicants commit that for as long as Duke's post-merger operations include regulated utility service in Kentucky, Duke's post-merger Board of Directors will include at least one non-employee member who is a customer of either Duke Kentucky, Duke Ohio, or Duke Indiana.<sup>2</sup>

### **III. Analysis of Commitment 48's Implications for Duke Energy**

The Joint Applicants readily accept the spirit and evident intent underlying the Commission's inclusion of Commitment 48, and agree with the importance of having directors who are knowledgeable about the Company's level of service within the communities served. In fact, the Joint Applicants pride themselves on being attentive and responsive to the needs of the communities they serve. This commitment to local communities – which is instilled and taught at every level of both Duke Energy and Progress Energy – is one of the major themes of the Joint Applicants' Application and direct testimony.<sup>3</sup> To be perfectly clear – the Joint Applicants have no problem accepting, endorsing and promoting the idea that the directors of a utility should reflect the character and perspectives of its service territory.

#### **A. Evaluation of the Director Commitment by Duke Energy's Management**

Upon receipt of the Commission's August 2, 2011 Order in this case, the Joint Applicants' management engaged in a considered review of the three additional commitments added by the Commission. It became clear that Commitment 48 was of a different nature than regulatory commitments previously imposed in transfer of control cases involving Duke Energy Kentucky, and involved a matter that was beyond the authority of management, but had to be reviewed with the appropriate governing and advisory committees of the Duke Energy Board of

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<sup>2</sup> *In the Matter of the Joint Application of Duke Energy Corporation, Cinergy Corp., Duke Energy Ohio, Inc., Duke Energy Kentucky, Inc., Diamond Acquisition Corp., and Progress Energy, Inc., for Approval of the Indirect Transfer of Control of Duke Energy Kentucky, Inc.*, Final Order, Appendix B, Regulatory Commitment 48, Case No. 2011-00124 (Ky. P.S.C., Aug. 2, 2011).

<sup>3</sup> See Application, ¶¶ 16-18, 24-26 and 38; Application, Exhibit J, pp. 16 and 19-29; Application, Exhibit L, pp. 12-23, 33-39.

Directors pursuant to governance charters of the Company. These governance provisions place all decisions about selection of board members with the shareholders of the Company or with its Board of Directors, and not with management. The Joint Applicants' August 9 motion for an extension of time in which to accept or reject the Commission's regulatory commitments was therefore made for the purpose of securing sufficient time to commence these consultations with governance authorities and not for any purpose of delay. Duke Energy's Corporate Governance Committee of its Board has since been consulted by means of a specially called meeting of the Committee wherein they concluded that a request for a rehearing would be appropriate for the limited purposes of revising and clarifying the contours of Commitment 48.

**B. Commitment 48 Implicates Fundamental Corporate Governance Issues**

Commitment 48 implicates fundamental corporate governance issues for Duke Energy in two primary respects. First, the composition of Duke Energy's post-merger Board of Directors was agreed to by the companies after lengthy negotiations and is a material aspect of the Merger Agreement. As such, any change to the Board's post-merger composition necessary to accommodate Commitment 48 would threaten to disrupt the bargain reached by Duke Energy and Progress Energy, and would change a fundamental element of Duke Energy's planned corporate governance. Second, Duke Energy's corporate governance documents – particularly its Amended and Restated Certificate of Incorporation – create a constraint that makes it impossible for Joint Applicants to easily comply with Commitment 48 even if the composition of their post-merger Board was not a material element of the merger transaction. Both of these issues are explained in turn below.

## 1. The Composition of Duke Energy's Post-Merger Board of Directors is a Material Aspect of the Merger Agreement

Duke Energy's Board of Directors currently consists of eleven members, and Progress Energy's Board of Directors currently consists of fourteen members.<sup>4</sup> Upon completion of the merger, the Board of Duke Energy, the surviving public company, will grow from eleven members to eighteen members – Duke Energy's existing 11 directors will be joined by 7 members of Progress Energy's existing Board.<sup>5</sup> Appendix A of the Merger Agreement is an enumeration of the division of responsibility between the Duke Energy director designees and the Progress Energy director designees on the post-merger Board of Directors of Duke Energy.<sup>6</sup> As specified there, at least one of Progress Energy's director designees will serve on each of the post-merger board committees and Progress Energy's director designees will chair the compensation and audit committees.<sup>7</sup> Duke Energy will designate the lead independent director and the Principles for Corporate Governance of Duke Energy will be amended to provide for scheduled retirements of directors at the first annual meeting following the calendar year in which they reach age seventy-one.<sup>8</sup> Under these provisions, the first scheduled vacancy on Duke Energy's post-merger Board is slated to occur at the Company's scheduled Annual Meeting of Shareholders in May of 2013.

The directors of the consolidated company designated by Duke Energy are the current directors of Duke Energy, having already been elected by vote of the shareholders of Duke

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<sup>4</sup> See Video Hearing Record, 10:34:40 (July 8, 2011).

<sup>5</sup> See Application, Exhibit E (Agreement and Plan of Merger, Section 1.06 and Exhibit A) (dated Jan. 8, 2011), pp. 7, 89.

<sup>6</sup> See *id.*, p. 89.

<sup>7</sup> See *id.*

<sup>8</sup> See *id.*

Energy at its Annual Meeting of Shareholders in May 2011, and Progress Energy's seven designated directors to be appointed at the transaction's closing have been identified to shareholders in the disclosure documents in connection with the special meetings of both companies scheduled for August 23, 2011 to vote on the merger transaction.

The composition and role of Duke Energy's post-merger Board of Directors was an important bargained-for aspect of the Merger Agreement. As described in the Form S-4 filed with the U.S. Securities and Exchange Commission and also filed in the record of this proceeding, more than three months before the Merger Agreement was executed, Mr. Rogers and Mr. Johnson first discussed a proposal to allocate board seats between the two companies.<sup>9</sup> Further internal and mutual discussions were held throughout October, November and December of 2010 and again on January 2, 2011 on this topic.<sup>10</sup> As late as the evening of January 7, 2011, the night before the merger was approved by the boards of both companies, Mr. Rogers and Mr. Johnson continued to discuss the post-merger Board's composition, and agreements they reached are reflected as material terms in the Merger Agreement.<sup>11</sup> Given the materiality of the composition of Duke Energy's post-merger board to the terms of the Merger Agreement as a whole, it is difficult for the Joint Applicants to reconfigure the post-merger board without disrupting the bargain reached in the Merger Agreement.

## **2. Duke Energy's Governing Authorities Constrain its Ability to Satisfy Commitment 48**

Constraints in Duke Energy's governing authorities also complicate its ability to accommodate Commitment 48. Article V, Subparagraph (b) of Duke Energy's Amended and

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<sup>9</sup> See Amendment No. 4 to Form S-4 Registration Statement of Duke Energy Corporation, p. 52 (filed July 5, 2011).

<sup>10</sup> See *id.*, pp. 52-58.

<sup>11</sup> See *id.*, p. 58.



Restated Certificate of Incorporation provides that the number of directors of Duke Energy “shall not be less than nine (9) nor more than eighteen (18), as may be fixed from time to time by the Board of Directors.”<sup>12</sup> Article VII of Duke Energy’s Amended and Restated Certificate of Incorporation then provides that the foregoing rule may only be amended “by the affirmative vote of at least 80% of the combined voting power of the then outstanding shares of stock of all classes of the Corporation entitled to vote generally in the election of directors...”<sup>13</sup> Finally, Subparagraph (e) of Article V provides that directors “shall be elected by the holders of voting stock and shall hold office until the next annual meeting of stockholders,” which will next occur in May of 2012.

Thus, what might have appeared to be an easy solution of simply appointing or electing a new director who satisfies the requirements of Commitment 48 is effectively foreclosed by the Company’s Articles of Incorporation. That is, absent a forced resignation of one of the negotiated and identified 18 directors of the new Duke Board, appointment of a 19<sup>th</sup> director is not possible without the scheduling of a special shareholder meeting and obtaining approval of over 80 percent of outstanding shares – which is nearly impossible.<sup>14</sup> Joint Applicants therefore seek rehearing so that a solution can be found which accommodates the Commission’s goal as expressed in Commitment 48, while also avoiding unnecessary conflicts with the bargain of the merger or with corporate governance requirements.

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<sup>12</sup> Application, Exhibit G, pp. 10-11. An analogous provision is also included in Section 3.01 of Duke Energy’s corporate by-laws.

<sup>13</sup> *Id.*, p. 12.

<sup>14</sup> For example, less than 60 percent of Duke Energy’s outstanding shares of common stock voted at the Company’s last Annual Meeting of Shareholders in May 2011. Moreover, even with the efforts of a hired proxy solicitor conducting a solicitation campaign for the purpose of soliciting votes in the Duke Energy/Progress Energy merger, Joint Applicants expect less than 80 percent of the outstanding shares of the Company to vote. These vote results are for the overall vote turnout. The vote result for a particular proposal, such as what would be required to amend the Amended and Restated Certificate of Incorporation, would, of course, be even lower as not every shareholder who submits a vote will vote for the proposal.

### **C. Commitment 48 Departs from Prior Commission Precedent**

Commitment 48 also exceeds the reach of similar director qualification regulatory commitments imposed or accepted by the Commission in prior proceedings. Most recently, in the case considering the direct transfer of control of jurisdictional utilities Kentucky Utilities Company (“KU”) and Louisville Gas and Electric Company (“LG&E”) from E.ON AG to PPL Corporation (“PPL”), the applicants voluntarily proposed a regulatory commitment whereby they would “endeavor” to have an individual resident of Kentucky on PPL’s Board of Directors.<sup>15</sup> The Commission accepted the applicants’ voluntary commitment and incorporated it into its final order as regulatory commitment thirty-nine:

PPL commits that for as long as it owns, controls, or manages LG&E or KU, PPL shall endeavor to have an individual resident of Kentucky on PPL’s Board of Directors. PPL shall commence a search for such director following the Acquisition. PPL shall have sole discretion in selecting qualified candidates and determining which individual is the best qualified for nomination.<sup>16</sup>

The terms of the present Commitment 48 are different from the PPL regulatory commitment in several respects. First, Commitment 48 was not voluntarily proposed by the Joint Applicants nor requested as part of the settlement process, while the PPL regulatory commitment was included in the application as part of a legacy commitment which arose in a prior proceeding involving a foreign acquirer. Second, Duke Energy would have an absolute duty to place a director qualifying under Commitment 48, and be at risk of violation if the commitment was not continuously satisfied where a customer-director left the Board for reasons

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<sup>15</sup> See *In the Matter of the Joint Application of PPL Corporation, E.ON AG, E.ON US Investments Corp., E.ON US LLC, Louisville Gas and Electric Company and Kentucky Utilities Company for Approval of an Acquisition of Ownership and Control of Utilities*, Joint Application, Ky. P.S.C. Case No. 2010-00204, p. 22 (filed May 28, 2010).

<sup>16</sup> *In the Matter of the Joint Application of PPL Corporation, E.ON AG, E.ON US Investments Corp., E.ON US LLC, Louisville Gas and Electric Company and Kentucky Utilities Company for Approval of an Acquisition of Ownership and Control of Utilities*, Final Order, Appendix C, Regulatory Commitment 39, Case No. 2010-00204 (Ky. P.S.C., Sept. 30, 2010).

beyond the Company's control. In sharp contrast, the PPL commitment requires that PPL "endeavor" to place a resident director on its board, with no risk of default if it appears it could not reasonably do so, or lost such a director's service through resignation, change of residency, death, or failure to be re-elected. The PPL commitment therefore provides a greater degree of flexibility for PPL to satisfy its commitment than that afforded to Duke Energy herein. Third, PPL is expressly given "sole discretion" in the selection of director candidates, but similar language is omitted from Commitment 48. Fourth, PPL's qualifying director is required only to be a resident of Kentucky, whereas Commitment 48 is more restrictive by requiring the qualifying director to be an actual customer of one of the Midwestern operating companies. Fifth, the Commission did not require PPL to recruit, select and nominate a non-employee director as it has Duke Energy. Theoretically, PPL could comply with the regulatory commitment by having an employee elected to its Board while such an option is not available to Duke Energy. The materiality of these distinctions is also significant in the context that the PPL transaction involved a direct transfer of control as opposed to an indirect transfer of control, as well as involved a substantially larger jurisdictional customer base and service territories than exists for Duke Energy Kentucky's operations.<sup>17</sup>

Indeed, the concept of the Commission designating director pre-qualifications appears to have originated in the acquisition of ownership and control of utilities jurisdictional to the Commission by foreign entities – when the English company PowerGen, PLC ("PowerGen") first acquired the operations of LG&E Energy Corp. For example, no director qualification conditions were imposed as part of the Commission's approval of: 1) the transfer of control of

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<sup>17</sup> The Joint Applicants do not suggest or imply that PPL Corporation will in any manner fail to exercise good faith or comply with the regulatory condition imposed in Case No. 2010-00204. The Joint applicants merely point out that there are substantial, unexplained differences in the plain language of the two regulatory commitments.

Western Kentucky Gas Utility Corporation to Energas Company;<sup>18</sup> 2) the reorganization of KU into a holding company;<sup>19</sup> 3) the reorganization of LG&E into a holding company;<sup>20</sup> 4) the indirect acquisition of control of ULH&P by Cinergy;<sup>21</sup> 5) the merger of KU and LG&E;<sup>22</sup> 6) the indirect transfer of control of Kentucky Power Company due to the merger of American Electric Power Company, Inc. and Central and South West Corporation;<sup>23</sup> 7) the acquisition of Columbia Gas of Kentucky by NiSource, Inc.;<sup>24</sup> or 8) the merger of Cinergy and Duke Energy.<sup>25</sup>

By contrast, considerable attention was given to the post-merger composition of the board of directors of PowerGen within the Commission's order approving PowerGen's acquisition of LG&E Energy Corp. eleven years ago:

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<sup>18</sup> See *In the Matter of the Application of Western Kentucky Gas Utility Corporation and Texas American Energy Corporation for Approval of the Transfer of Ownership and Control of Western Kentucky Gas Utility Corporation to Energas Company*, Final Order, Case No. 10063 (Ky. P.S.C., Dec. 18, 1987).

<sup>19</sup> See *In the Matter of the Application of Kentucky Utilities Company to Enter into an Agreement and Plan of Exchange and to Carry Out Certain Transactions in Connection Therewith*, Order, Case No. 10296 (Ky. P.S.C., Oct 6, 1988).

<sup>20</sup> See *In the Matter of the Application of Louisville Gas and Electric Company for an Order Approving an Agreement and Plan of Exchange and to Carry Out Certain Transactions in Connection Therewith*, Final Order, Case No. 1989-00374 (Ky. P.S.C., May 25, 1990).

<sup>21</sup> See *In the Matter of the Application of Cincinnati Gas & Electric Company and Cinergy Corp. for Approval of the Acquisition of Control of The Union Light, Heat and Power Company by Cinergy Corp.*, Final Order, Case No. 1994-00104 Ky. P.S.C., May 13, 1994).

<sup>22</sup> See *In the Matter of the Joint Application of Louisville Gas and Electric Company and Kentucky Utilities Company for Approval of Merger*, Final Order, Case No. 1997-00300 (Ky. P.S.C., Sept. 12, 1997).

<sup>23</sup> See *In the Matter of the Joint Application of Kentucky Power Company, American Electric Power Company, Inc. and Central and South West Corporation Regarding a Proposed Merger*, Final Order, Case No. 1999-00149 (Ky. P.S.C. June 14, 1999).

<sup>24</sup> See *In the Matter of the Joint Application of NiSource Inc., New NiSource Inc., Colombia Energy Group and Columbia Gas of Kentucky for Approval of a Merger*, Final Order, Case No. 2000-00129 (Ky. P.S.C., June 30, 2000).

<sup>25</sup> See *In the Matter of the Joint Application of Duke Energy Corporation, Duke Energy Holding Corp., Deer Acquisition Corp., Cougar Acquisition Corp., Cinergy Corp., The Cincinnati Gas & Electric Company and The Union Light, Heat and Power Company for Approval of a Transfer and Acquisition of Control*, Final Order, Case No. 2005-00228 (Ky. P.S.C., Nov. 29, 2005).

Under the terms of the Merger Agreement, PowerGen's ten-member board of directors will be enlarged to allow for the appointment of LG&E Energy's CEO to that board. PowerGen has committed that there will be a seat on the PowerGen board filled by a United States citizen.

...

While the Applicants have committed to dedicating a seat on the PowerGen Board to a citizen of the United States, that individual must also reside within the LG&E or KU service territories to ensure that Kentucky's interests are adequately heard by an international board of directors.<sup>26</sup>

Recognizing that the foreign company's board had "the potential to substantially affect the quality of utility service furnished to Kentucky customers," the Commission imposed a regulatory commitment on PowerGen that it include a United States citizen on its board, as follows:

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PowerGen commits that for as long as it owns, controls, or manages LG&E or KU, there shall be a seat on the PowerGen Board occupied by a United States citizen who resides in the service territories of LG&E or KU. PowerGen also commits that the first occupant of that seat shall be the CEO of LG&E Energy.<sup>27</sup>

The same attention was given in the subsequent acquisition of PowerGen by the German company E.ON AG when the Commission imposed a regulatory commitment that preserved a seat on the PowerGen board for a United States citizen residing in the service territory of either KU or LG&E, but did not require the board of E.ON AG to include a member with direct ties to

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<sup>26</sup> See *In the Matter of the Joint Application of PowerGen, PLC, LG&E Energy Corp., Louisville Gas and Electric Company and Kentucky Utilities Company for Approval of a Merger*, Final Order, Case No. 2000-00095, pp. 13-14 (Ky. P.S.C., May 15, 2000). On a side note, the regulatory commitment that the chief executive officer of a utility holding company will meet regularly with the Commission also appears to trace its roots to the PowerGen merger case. See *id.*, p. 12.

<sup>27</sup> See *id.* p. 53.

the Commonwealth.<sup>28</sup> Thus, the Commission sought to preserve a local voice in the corporate governance structure of an intermediate holding company without disrupting the governance structure of the ultimate corporate parent. More recently, the Commission imposed a regulatory commitment that forty percent of the directors of Kentucky-American Water Company must be residents of the water utility's service territory, but did not impose any qualifications on the directors of Kentucky-American's intermediate or ultimate corporate parents.<sup>29</sup>

In summary, PPL and PowerGen appear to be the only utility holding companies upon which the Commission has imposed director qualifications as conditions to approval of a transfer of control. PowerGen's board had to include one American citizen who resided in the service territory of KU or LG&E, and PPL shall endeavor to include a resident of Kentucky on its Board. Although the Commission also imposed a director qualification condition as part of RWE's acquisition and subsequent divestiture of Kentucky-American Water Company, the condition only applied to Kentucky-American and not to its parents. On all other occasions of which the Joint Applicants are aware, the Commission has left the selection, recruitment and nomination of holding company directors to the company's board of directors and shareholders – the corporate constituencies having the responsibility to do so under the articles of incorporation

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<sup>28</sup> See *In the Matter of the Joint Application for Transfer of Louisville Gas and Electric Company and Kentucky Utilities Company in Accordance with E.ON AG's Planned Acquisition of PowerGen PLC*, Final Order, Appendix A, Regulatory Commitment 45, Case No. 2001-00104 (Ky. P.S.C., Aug. 6, 2001).

<sup>29</sup> See *In the Matter of the Application for Approval of the Transfer of Control of Kentucky-American Water Company to REW Aktiengesellschaft and Thames Water Aqua Holdings GMBH*, Final Order, Appendix A, Regulatory Commitment 49, Case No. 2002-00018 (Ky. P.S.C., May 30, 2002) (“At least 40 percent of the members of KAWC's Board of Directors will be persons who are not employees or officers of RWE, Thames, AWWC, or any other RWE affiliated entity, and who reside within the area in which KAWC serves.”); see also *In the Matter of the Joint Petition of Kentucky-American Water Company, Thames Water Aqua Holdings GMBH, RWE Aktiengesellschaft, Thames Water Aqua US Holdings, Inc., Apollo Acquisition Company and American Water Works Company, Inc. for Approval of a Change of Control of Kentucky-American Water Company*, Final Order, Case No. 2002-00317 (Ky. P.S.C., Dec. 20, 2002); *In the Matter of the Joint Petition of Kentucky-American Water Company, Thames Water Aqua Holdings GMBH, RWE Aktiengesellschaft, Thames Water Aqua US Holdings, Inc., and American Water Works Company, Inc. for Approval of a Change in Control of Kentucky-American Water Company*, Final Order, Appendix A, Regulatory Commitment 32, Case No. 2006-00197 (Ky. P.S.C., Apr. 16, 2007).

and the constituencies accepting the primary risk for any adverse impacts arising from the execution of that responsibility. The Commission's August 2, 2011 Order does not take into account these distinctions from past precedent.

Because Commitment 48 reaches higher up the corporate ladder, provides less flexibility than that afforded in prior cases, and constitutes the first imposition of a director qualification commitment upon a holding company in an indirect transfer of control case, it presents a departure from the Commission's prior orders. Rehearing should be granted for the limited purpose of revising Commitment 48 so that the Commission's objective in this proceeding may be reconciled with precedent on this issue.

#### **IV. Joint Applicants Respectfully Request Clarification and Revision of Commitment 48**

Joint Applicants request clarification that so long as Michael Browning, a current Board member of Duke Energy who resides in Indiana, satisfies the definition of "customer" under Indiana law, his service on Duke Energy's Board satisfies Commitment 48. In addition, the Joint Applicants request a modification of Commitment 48 for reasons described below. The Joint Applicants accept the objective behind Commitment 48 and are willing to take all reasonable steps to fulfill the Commission's expectations that the interests of Duke Energy's Midwestern customers be represented on the Duke Energy Board.

##### **A. Petitioners Seek Clarification that Mr. Browning would Satisfy Commitment 48**

Commitment 48 does not specify whether "customer" shall be defined by the law of the applicable Midwestern jurisdiction or only the definition of "customer" set forth in 807 KAR 5:006, Section 1. Duke Energy has explored whether Michael Browning, a current Duke Energy Board member who resides in Indiana, would meet the Commission's requirement. Although Mr. Browning is a resident of Indiana, his residence is within the Indianapolis Power and Light service

territory and he is not a customer of Duke Energy Indiana at that primary address. However, Mr. Browning and his spouse own another residence and several businesses which do receive service from Duke Energy Indiana and Joint Applicants are taking any necessary steps with Mr. Browning to ensure that he is a “customer” for one or more of these services. The Joint Applicants seek clarification that so long as Mr. Browning is a “customer” of Duke Energy Indiana with respect to that residence or business locations under the relevant provisions of Indiana Law, Mr. Browning shall be considered to satisfy the requirement of Commitment 48, provided he remains a Board member and such a customer.

**B. Joint Applicants Request Revision to Commitment 48 on Rehearing**

Depending upon whether Mr. Browning’s service on the Duke Energy Board satisfies the Commission’s expectations, the Joint Applicants have identified two alternatives to give Duke Energy the flexibility necessary to avoid an unforeseen default or disruption to its corporate governance. Both of these alternatives – and perhaps others – are acceptable to the Joint Applicants.

The preferred option borrows from the regulatory commitment imposed upon PPL in its recent acquisition of KU and LG&E. There, the holding company made a commitment that it would “endeavor” to have at least one member of its board be a resident of Kentucky. Along this line, the Joint Applicants propose the following alternative to Commitment 48:

Joint Applicants commit that for as long as Duke’s post-merger operations include regulated utility service in Kentucky, Duke shall endeavor to have an individual resident of Kentucky, Ohio or Indiana on its Board of Directors. Duke shall have sole discretion in selecting qualified candidates and determining which individual is the best qualified for nomination.

This modified commitment allows Michael Browning’s service on Duke Energy’s Board of Directors to satisfy Commitment 48 based on his residency within a state of the Midwest



service territory, provides Duke Energy with some future protection should an event of technical default ever arise, while at the same time giving the Commission an opportunity to hold Duke Energy accountable on this issue in the long-term in the same manner as the equivalent PPL condition.

Alternatively, and provided that Mr. Browning's circumstances satisfy the "customer" requirements, the Joint Applicants suggest that language should be added to the existing Commitment 48 to expressly clarify that Duke Energy has some future protections in the event that the position of its director satisfying Commitment 48 becomes vacant through no fault of Duke Energy. A modified commitment along these lines would be:

Joint Applicants commit that for as long as Duke's post-merger operations include regulated utility service in Kentucky, Duke's post-merger Board of Directors will include at least one non-employee member who is a customer of Duke Kentucky, Duke Ohio, or Duke Energy Indiana. However, in the event that any such person ceases to be a Board member and a vacancy is created due to death, resignation, incapacity, removal, failure to be elected or re-elected by Duke's shareholders, or for any other reason not enumerated herein, Duke shall take reasonable measures to fill this vacancy with another qualified Board member satisfying the above criteria. During the time that is required to identify a substitute Board member and obtain the necessary approvals to fill such vacancy Duke shall not be in violation of this regulatory commitment.<sup>30</sup>

The Joint Applicants eagerly desire to demonstrate that they accept and endorse the Commission's purpose of having a Midwestern perspective present in Duke Energy's Board deliberations. This is in fact already occurring. The foregoing alternatives to the existing Commitment should allow Duke Energy to accomplish this objective in the most efficient and least disruptive manner possible. However, to be certain that the Commission, and the Attorney General, are satisfied with Duke Energy's efforts to prospectively comply with this regulatory

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<sup>30</sup> As with the preferred alternative above, Joint Applicants would request the Commission to consider adopting the requirement of a resident of one of the Midwest states, rather than a "customer" of one of the utilities.

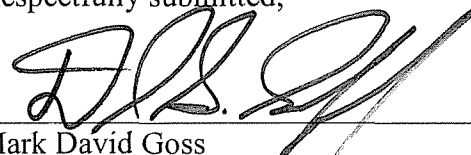
commitment in whatever final form it may take, the Joint Applicants are willing to include this item as a recurring agenda item for the occasions when the chief executive officer of Duke Energy will meet with the Commission in fulfillment of Commitment 18.

**V. Summary**

Commitment 48 in its current form risks upsetting a material term of the Merger Agreement or violating Duke Energy's governing authorities, and places the Company at risk of being in default through events beyond its control. Although it goes well beyond those imposed in prior Commission proceedings, the Joint Applicants readily accept the spirit and evident intent underlying the Commission's inclusion of Commitment 48, and agree with the importance of having directors who are knowledgeable about the Company's level of service within the communities served. With minimal modifications, the Joint Applicants can accept Commitment 48 and move forward with their continuing mission to supply safe, reliable and affordable electric and natural gas service to customers in the northern Kentucky region. For all of the reasons expressed herein, the Joint Applicants respectfully request the Commission to expeditiously grant rehearing for the limited purpose of clarifying and revising Commitment 48 as set forth herein.

This 19<sup>th</sup> day of August, 2011.

Respectfully submitted,



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**CERTIFICATE OF SERVICE**

I hereby certify that the foregoing was mailed, first class postage prepaid, this 19<sup>th</sup> day of August, 2011 to the following parties of record:

Hon. Dennis G. Howard, II  
Hon. Lawrence Cook  
Assistant Attorneys General  
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