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Rocco.O.D'Ascenzo@duke-energy.com
Rocco O. D'Ascenzo
Associate General Counsel

VIA OVERNIGHT DELIVERY

RECEIVED

SEP 26 2014

PUBLIC SERVICE
COMMISSION

September 25, 2014

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

Re: 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 Instruments
Case No. 2014-XXX

And

In the Matter of the Application of Duke Energy Kentucky, Inc. for an Order to Enter into up to \$25,000,000 Principal Amount of Capital Lease Obligations
Case No. 2014-XXX *Case No. 2014-00344*

Dear Mr. Derouen:

Enclosed please find an original and twelve copies of each of the above-referenced Applications.

Please assign a separate case number for each enclosed Application and file-stamp and return two extra copies of each in the enclosed overnight envelope.

Feel free to contact me should you have any questions.

Respectfully submitted,

Rocco D'Ascenzo (92796)
Associate General Counsel
Duke Energy Kentucky, Inc.
139 East Fourth Street, 1313 Main
Cincinnati, Ohio 45201-0960
(513) 287-4320
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Rocco.D'ascenzo@duke-energy.com
Counsel for Duke Energy Kentucky, Inc.

RECEIVED

SEP 26 2014

PUBLIC SERVICE
COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of the Application of Duke Energy)	
Kentucky, Inc. for an Order to Enter into up to)	
\$25,000,000 Principal Amount of Capital Lease)	Case No. 2014- <u>00344</u>
Obligations)	

APPLICATION FOR CAPITAL LEASE AUTHORITY

Pursuant to KRS 278.300 and 807 KAR 5:001 Sections 12 and 18, Duke Energy Kentucky, Inc. (Duke Energy Kentucky) respectfully requests that the Commission authorize Duke Energy Kentucky to issue capital leases, and enter into all necessary agreements and other documents relating thereto, as more fully described herein. In support of this Application, Duke Energy Kentucky states as follows:

1. **807 KAR 5:001 Section 18(1)(a).** Pursuant to 807 KAR 5:001, Section 14(2), Duke Energy Kentucky is a Kentucky Corporation that was originally incorporated on March 20, 1901, is in good standing, and, as a public utility, as that term is defined in KRS 278.010(3), is subject to the Commission’s jurisdiction. Duke Energy Kentucky is engaged in the business of providing retail gas and electric service to its customers in Northern Kentucky in various municipalities and unincorporated areas of Kenton, Campbell, Boone, Gallatin, Grant, and Pendleton Counties. Duke Energy Kentucky is thus subject to the Commission’s jurisdiction. Duke Energy Kentucky’s business address is 139 East Fourth Street, Cincinnati, Ohio 45202. The Company’s local office in Kentucky is Duke Energy Envision Center, 4580 Olympic Boulevard Erlanger, Kentucky 41018. Duke Energy Kentucky’s email address is

KYfilings@duke-energy.com. Duke Energy Kentucky's articles of incorporation are on file with the Commission in Case No. 2013-00097 and are hereby incorporated by reference.

2. **807 KAR 5:001 Section 18(1)(b)**. As of June 30, 2014, the original cost of Duke Energy Kentucky's property was \$1,761,175,000. The Company's principal properties consist of electric generating plants, and gas and electric distribution facilities.

3. **807 KAR 5:001 Section 18(1)(c)**. Duke Energy Kentucky proposes, with the necessary consent and authority of this Commission, to enter into from time to time over a period ending December 31, 2016, up to \$25 million principal amount of capital lease obligations (Capital Leases). Duke Energy Kentucky proposes to utilize Capital Leases purely as another form of financing its capital requirements. The Capital Leases will have structures and terms similar to other forms of debt financing, but with the potential, in certain instances, to lower the overall cost associated with financing property acquisitions.

Capital Leases will be used to finance new property, including construction, or re-finance existing property, in order to optimize the cost of financing commensurate with such property's expected life (such property being more fully described in "Property Expected to be Leased" below).

Advantages of Leasing. Leasing can allow Duke Energy Kentucky to access lower cost funds. One reason for this is because lessors often have a higher credit rating than Duke Energy Kentucky, and therefore, can secure capital at a lower cost. Capital leasing may also deliver lower cost funds because the lessor may be better able to use the tax depreciation benefits than the lessee, thus lowering the cost of financing. Some portion of this lower cost may be passed on to Duke Energy Kentucky, along with a spread for profit to the lessor, which usually is at a cost below what Duke Energy Kentucky could have obtained otherwise.

Established financing practices are employed to determine whether ownership or lease (including sale/leaseback) of certain assets is the appropriate method of financing. The impact on earnings and cash flow for available financing alternatives are analyzed.

Capital lease financing is similar to debt except that for certain acquisitions it can be more easily tailored to match the useful life of the acquisition. It is often more effective to enter into a capital lease whose maturity is concurrent with an asset's useful life than to issue a large amount of bonds for a basket of assets having various useful lives. When compared to bonds, the effective cost of capital lease financing may be lower due to reduced transaction costs. And, in the case of variable rate leases, small interest spreads over short-term borrowing indexes such as London Interbank Offered Rate (LIBOR) may be negotiated, thus making Capital Leases a cost-effective source of financing which may lower overall utility costs.

Property Expected to be Leased. The property expected to be leased will consist of equipment used in Duke Energy Kentucky's operations including, but not limited to, meters, computers and office equipment, and intangible property such as software and site licenses (collectively, the Property). The Property may also include land, plant or equipment in service, plant under construction or land, plant or equipment to be acquired or constructed.

Accounting. Duke Energy Kentucky proposes to account for the Capital Leases as prescribed by the Federal Energy Regulatory Commission Uniform System of Accounts as currently in effect.

The amount financed under each Capital Lease, excluding transaction costs, is not expected to be more than the net capitalized cost of the Property or the appraised value of the Property (in the event more than the capitalized cost is financed).

In accordance with generally accepted accounting principles, the net capitalized cost of property usually includes installation, training, allowance for funds, administrative overhead and other costs capitalized in connection with acquiring and placing the property in service. Such costs are expected to be included in the Property cost financed under a Capital Lease.

Method of Transacting Capital Leases. To effectuate the lease transactions, Duke Energy Kentucky will: (1) obtain third-party lease financing for Property acquisitions; or (2) in the case of existing Property, sell the Property to a third-party finance lessor (Lessor), and simultaneously therewith Duke Energy Kentucky will lease the Property back from the Lessor. In connection therewith, the terms of each Capital Lease will be approved by Duke Energy Kentucky's Board of Directors, or by such persons authorized by the Board, and it is anticipated that an agreement setting forth the terms of each Capital Lease will be executed.

In the case of new Property that is acquired or constructed, the Lessor will either: (a) pay the vendor and Duke Energy Kentucky for their respective costs associated with the acquisition; or (b) reimburse Duke Energy Kentucky for the capitalized cost of the property, with Duke Energy Kentucky concurrently paying the vendor the invoice cost; this latter option being undertaken solely to allow for administrative efficiencies.

Related Agreements. Duke Energy Kentucky may enter into one or more participation agreements with its affiliates and the Lessor in connection with the Capital Leases, with such agreements defining Duke Energy Kentucky's role as principal and, as applicable, agent on behalf of its affiliates for billing and payment remittance purposes. Such arrangements will be undertaken solely for administrative efficiencies and convenience of the parties involved.

End of Term Options. At the end of each initial or renewal lease term, it is anticipated that Duke Energy Kentucky will have an option to either: (a) renew each Capital Lease pursuant

to arm's length negotiation with the then existing Lessor or other lessors; (b) purchase the Property; or (c) terminate the Capital Lease.

Pricing Parameters. Duke Energy Kentucky has parameters within which the final negotiated Capital Leases, including sale and leasebacks, and rental obligations will fall, and requests authority to execute Capital Leases of the Property within such parameters. The parameters, as set forth in Exhibit A, would allow Duke Energy Kentucky to consummate transactions when it believes it is prudent to do so provided the terms are within the parameters.

Commission Authorization. Duke Energy Kentucky requests that the Commission issue its order authorizing the Capital Leases now, prior to the time Duke Energy Kentucky reaches specific agreement with respect to the terms of such lease transactions, to provide the Company flexibility in entering into the leases. Such Commission approval will not relieve Duke Energy Kentucky of its responsibility to obtain the best terms available for the structure selected and, therefore, it is appropriate and reasonable for this Commission to authorize Duke Energy Kentucky to agree to such terms and prices consistent with said parameters.

4. **807 KAR 5:001 Section 18(1)(d).** The proceeds from the Capital Lease obligations are expected to be used: (a) for necessary acquisitions of property, and estimated capital expenditures of approximately \$58 million in 2014 and \$77 million in 2015 and \$90 million in 2016; (b) for re-financing existing property; (c) for such additional expenditures as contemplated by KRS 278.300; or (d) for other lawful corporate purposes. Therefore, Capital Lease transactions are necessary and appropriate for and consistent with the proper performance by Duke Energy Kentucky of its services to the public, will not impair its ability to perform those services, and are reasonably necessary and appropriate for such purposes.

5. **807 KAR 5:001 Section 18(1)(e).** See Exhibit B concerning estimated capital expenditures, attached hereto, and made a part hereof. Duke Energy Kentucky does not currently have any specific agreements other than those entered into under the existing authority and as reported to the Commission in 2012-00576. Duke Energy Kentucky requests that the Commission issue its order authorizing the Capital Leases now, prior to the time Duke Energy Kentucky reaches specific agreement with respect to the terms of such lease transactions, to provide the Company flexibility in entering into the leases. Duke Energy Kentucky will notify the Commission of the terms of any such agreements if and when the Company enters in to a Capital Lease.

6. **807 KAR 5:001 Section 12(1)(f).** This section is not applicable, since no specific discharge of obligations is contemplated at this time from transacting the Capital Leases.

7. **807 KAR 5:001 Section 12(1)(g).** In Case No. 2012-00576, the Commission approved up to \$25 million in principal amount of Capital Lease obligations for the period ending December 31, 2014. As of June 30, 2014, there remained approximately \$25 million of available authority.

8. **807 KAR 5:001 Section 12 and Section 18(2)(a).** Duke Energy Kentucky is filing the following information in Exhibit C, which is incorporated herein and made a part of this application:

<u>Exhibit C</u> <u>Page</u>	<u>Description</u>	<u>807 KAR 5:001</u> <u>Section Reference</u>
	Financial Exhibit	12 and 18(2)(a)
1	Amount and kinds of stock authorized	12(2)(a)
1	Amount and kinds of stock issued and outstanding	12(2)(b)

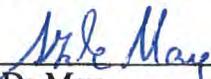
1	Terms of preference or preferred stock	12 (2)(c)
1	Brief description of each mortgage on property of Duke Energy Kentucky	12(2)(d)
1-2	Amount of bonds authorized and issued and related information	12(2)(e)
2	Notes outstanding and related information	12(2)(f)
2-3	Other indebtedness and related information	12(2)(g)
4	Dividend information	12(2)(h)
4-6	Detailed Income Statement and Balance Sheet	12(2)(i)

9. **807 KAR 5:001 Section 18(2)(b).** This section is not applicable, as there are no related deeds of trust or mortgage documents relevant to this application.

10. **807 KAR 5:001 Section 18(2)(c).** The proposed construction is primarily comprised of installations, improvements and extensions in the ordinary course of business as a utility. It is therefore impractical to submit maps and plans pertaining thereto.

WHEREFORE, Duke Energy Kentucky respectfully requests that the Commission issue an order authorizing Duke Energy Kentucky to enter into up to \$25 million principal amount of Capital Leases, including sale and leasebacks, for the purposes herein stated and in a manner as herein set forth, and authorizing Duke Energy Kentucky to account for such Capital Leases in the manner as herein set forth.

DUKE ENERGY KENTUCKY, INC.

By: 
Stephen G. De May
Vice President and Treasurer

Its Attorneys:



Rocco D'Ascenzo
Associate General Counsel
Amy B. Spiller
State Regulatory General Counsel
Duke Energy Kentucky, Inc.
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VERIFICATION

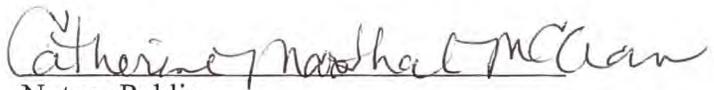
State of North Carolina)
) SS:
County of Mecklenburg)

Stephen G. De May, being first duly sworn, states that he is Vice President and Treasurer of Duke Energy Business Services LLC; that he has read the foregoing application; and that the contents are true to the best of his knowledge, information and belief.



Stephen G. De May

Subscribed and sworn to before me, this 24 day of September, 2014.



Catherine Marshall McCann
Notary Public
my Commission expires 7-6-2015

Duke Energy Kentucky, Inc.

Capital Lease Parameter Summary

Property Description:	The property expected to be leased will consist of equipment used in Duke Energy Kentucky's operations including, but not limited to, meters, computers and office equipment, and intangible property such as software and site licenses (collectively, the "Property"). The Property may also include land, plant or equipment in service, plant under construction or land, plant or equipment to be acquired or constructed.
Use of Proceeds:	To acquire property, fund construction expenditures, refinance existing property or for other general corporate purposes.
Principal Amount:	Up to \$25 million, depending on the capitalized cost or appraised value of the property, plus transaction costs.
Lessor:	One or more lessors to be named.
Lease Term:	To be determined.
Lease Cost:	Aggregate cost of rental payments, commitment fees and closing costs during each initial or renewal period that results in an interest rate (implicit or otherwise) that is equal to or less than those generally obtainable on capital lease financing having the same or reasonably similar terms offered to, or entered into, by utility companies or utility holding companies of the same or reasonably comparable credit quality.

**Duke Energy Kentucky
Capital Expenditures
(\$ in thousands)**

Expansion	2014	2015	2016
Grid Modernization	\$ 3,700	\$ 800	\$ 800
Customer Adds	8,100	8,900	9,500
Other	800	10,000	-
Total Expansion	\$ 12,600	\$ 19,700	\$ 10,300

Maintenance	2014	2015	2016
Regulated Operations	\$ 14,000	\$ 20,400	\$ 43,700
Power Delivery	17,700	20,100	18,600
Gas Delivery	11,000	15,200	15,700
Customer Service	100	200	200
Other FE&G	2,000	1,200	900
Total Maintenance	\$ 44,800	\$ 57,100	\$ 79,100

Environmental	2014	2015	2016
Environmental Control	\$ 100	\$ -	\$ 500
Total Environmental	\$ 100	\$ -	\$ 500

Total Forecast Capital Expenditures	\$ 57,500	\$ 76,800	\$ 89,900
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Notes:

1) Includes all additions (account 107000) and retirements (account 108000), including all AFUDC

FINANCIAL EXHIBIT

(1) Amount and kinds of stock authorized

1,000,000 shares of Capital Stock \$15 par value amounting to \$15,000,000 par value.

(2) Amount and kinds of stock issued and outstanding

585,333 shares of Capital Stock \$15 par value amounting to \$8,779,995 total par value. Total Capital Stock and Additional Paid-in Capital as of June 30, 2014:

Capital Stock and Additional Paid-in Capital
As of 6/30/2014
(\$ per 1,000)

Capital Stock	\$8,780
Premiums thereon	18,839
Total Capital Contributions from Parent (since 2006)	8,594
Contribution from Parent Company for Purchase of Generation Assets	<u>140,061</u>
Total Capital Stock and Additional Paid-in-Capital	<u>\$176,274</u>

(3) Terms of preference or preferred stock whether cumulative or participating, or on dividends or assets or otherwise.

There is no preferred stock authorized, issued or outstanding.

(4) Brief description of each mortgage on property of applicant, giving date of execution, name of mortgagor, name or mortgagee, or trustee, amount of indebtedness authorized to be secured thereby, and the amount of indebtedness actually secured, together with any sinking fund provision.

Duke Energy Kentucky does not have any liabilities secured by a mortgage.

(5) Amount of bonds authorized, and amount issued, giving the name of the public utility which issued the same, describing each class separately, and giving the date of issue, face value, rate of interest, date of maturity and how secured, together with the amount of interest paid thereon during the last fiscal year.

The Company has three outstanding issues of unsecured senior debentures issued under an Indenture dated December 1, 2004, between itself and Deutsche Bank Trust Company Americas, as Trustee, as supplemented by one Supplemental Indenture. The Indenture allows the Company to issue debt securities in an unlimited amount from time to time. The Debentures issued under the Indenture are the following:

Supplemental Indenture	Date of Issue	Principal Amount Authorized and Issued	Principal Amount Outstanding	Rate of Interest	Date of Maturity	Interest Paid Year 2013
Not Applicable	12/9/2004	40,000,000	40,000,000	5.000%	12/15/2014	2,000,000
1 st Supplemental	3/10/2006	50,000,000	50,000,000	5.750%	3/10/2016	2,875,000
1 st Supplemental	3/10/2006	65,000,000	65,000,000	6.200%	3/10/2036	4,030,000
2 nd Supplemental	9/22/2009	100,000,000	<u>100,000,000</u>	4.650%	10/1/2019	<u>4,650,000</u>
			<u>155,000,000</u>			<u>13,555,000</u>

- (6) **Each note outstanding, giving date of issue, amount, date of maturity, rate of interest, in whose favor, together with amount of interest paid thereon during the last fiscal year.**

Not applicable.

- (7) **Other indebtedness, giving same by classes and describing security, if any, with a brief statement of the devolution or assumption of any portion of such indebtedness upon or by person or corporation if the original liability has been transferred, together with amount of interest paid thereon during the last fiscal year.**

The Company has two series of Pollution Control Revenue Refunding Bonds issued under a Trust Indenture dated as of August 1, 2006, and a Trust Indenture dated as of December 1, 2008, between the County of Boone, Kentucky and Deutsche Bank National Trust Company as Trustee. The Company's obligation to make payments equal to debt service on the Bonds is evidenced by a Loan Agreement dated as of August 1, 2006 and December 1, 2008 between the County of Boone, Kentucky and Duke Energy Kentucky. The Bonds issued under the Indentures are as follows:

Indenture	Date of Issue	Principal Amount Authorized and Issued	Principal Amount Outstanding	Rate of Interest	Date of Maturity	Interest Paid Year 2013
Series 2008A	12/01/2011	50,000,000	50,000,000	1.08% ⁽¹⁾	8/1/2027	540,446
Series 2010	11/24/2010	26,720,000	<u>26,720,000</u>	0.09% ⁽²⁾	8/1/2027	<u>23,698</u>
			<u>76,720,000</u>			<u>564,144</u>

⁽¹⁾ The interest rate represents the average floating-rate of interest on the bonds for 2011. The interest rate on the bonds resets every 35 days through an auction process.

⁽²⁾ The variable-rate debt was swapped to a fixed rate of 3.86% for the life of the debt.

The Company has issued and has outstanding as of June 30, 2014 the following capital leases:

Series	Date of Issue	Principal Amount Authorized and Issued	Principal Amount Outstanding	Rate of Interest	Date of Maturity
2005	12/30/2005	2,079,031	468,532	4.893%	12/30/2014
2006	12/28/2006	2,406,336	808,733	5.000%	12/30/2015
Erlanger	12/30/2006	2,100,000	1,219,323	8.634%	09/30/2020
2007	12/31/2007	3,066,955	1,353,820	5.115%	12/31/2016
2009	04/21/2009	3,429,432	1,870,815	4.821%	04/21/2018
2010	06/18/2010	<u>955,061</u>	<u>612,547</u>	3.330%	06/18/2019
		<u>18,122,344</u>	<u>6,333,770</u>		

The Company also has outstanding as of June 30, 2014, long term debt in the amount of \$851,494 associated with the July 31, 2007 sale of a gas storage cavern carrying an interest rate of 4.77% and a maturity date of July 31, 2027.

- (8) **Rate and amount of dividends paid during the last five (5) previous fiscal years, and the amount of capital stock on which dividends were paid each year.**

DIVIDENDS PER SHARE

<u>Year Ending</u>	<u>Per Share</u>	<u>Total</u>	<u>No. of Shares</u>	<u>Par Value of Stock</u>
December 31, 2009	0.00	0	585,333	8,779,995
December 31, 2010	0.00	0	585,333	8,779,995
December 31, 2011	230.64	135,000,000	585,333	8,779,995
December 31, 2012	17.08	10,000,000	585,333	8,779,995
December 31, 2013	68.34	40,000,000	585,333	8,779,995

- (9) **Detailed Income Statement and Balance Sheet**

See the attached pages for the detailed Income Statement for the twelve months ended June 30, 2014 and the detailed Balance Sheet as of June 30, 2014.

DUKE ENERGY KENTUCKY, INC.
CONDENSED STATEMENTS OF OPERATIONS
 (Unaudited)
 (In thousands)

	Twelve Months Ended	
	June 30, 2014	
Operating Revenues		
Electric	\$	357,412
Gas		123,460
Total operating revenues		480,872
Operating Expenses		
Fuel used in electric generation and purchased power		165,529
Natural gas purchased		57,849
Operation, maintenance and other		127,209
Depreciation and amortization		44,112
Property and other taxes		12,576
Total operating expenses		407,275
Gains on Sales of Other Assets and Other, net		(1,375)
Operating Income		72,222
Other Income and Expenses, net		2,149
Interest Expense		15,732
Income Before Income Taxes		58,639
Income Tax Expense		21,744
Net Income		\$ 36,895

DUKE ENERGY KENTUCKY, INC.
Condensed Balance Sheets
(Unaudited)

(in thousands, except share amounts)	June 30, 2014	December 31, 2013
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 12,145	\$ 13,038
Receivables (net of allowance for doubtful accounts of \$216 at June 30, 2014 and \$229 at December 31, 2013)	12,877	4,246
Receivables from affiliated companies	17,538	25,999
Notes receivable from affiliated companies	—	1,267
Inventory	50,929	41,667
Regulatory assets	15,671	4,038
Other	12,644	10,906
Total current assets	121,804	101,161
Investments and Other Assets		
Intangibles, net	56	115
Other	7,630	7,983
Total investments and other assets	7,686	8,098
Property, Plant and Equipment		
Cost	1,761,175	1,741,308
Accumulated depreciation and amortization	(739,237)	(728,396)
Net property, plant and equipment	1,021,938	1,012,912
Regulatory Assets and Deferred Debits		
Regulatory Assets	43,122	41,437
Other	2,067	2,138
Total regulatory assets and deferred debits	45,189	43,575
Total Assets	1,196,617	1,165,746
LIABILITIES AND COMMON STOCKHOLDER'S EQUITY		
Current Liabilities		
Accounts payable	16,200	25,536
Accounts payable to affiliated companies	6,461	18,204
Notes payable to affiliated companies	30,084	—
Taxes accrued	11,576	10,306
Interest accrued	3,561	3,442
Current maturities of long-term debt	41,623	41,688
Regulatory liabilities	3,269	2,390
Other	21,584	18,462
Total current liabilities	134,358	120,028
Long-term Debt	296,798	297,365
Deferred Credits and Other Liabilities		
Deferred income taxes	261,228	257,220
Investment tax credits	1,200	1,304
Accrued pension and other post-retirement benefit costs	10,138	10,776
Asset retirement obligations	6,389	6,253
Regulatory liabilities	65,894	69,495
Other	25,149	25,351
Total deferred credits and other liabilities	369,998	370,399
Commitments and Contingencies		
Common Stockholder's Equity		
Common Stock, \$15.00 par value, 1,000,000 shares authorized and 585,333 shares outstanding at June 30, 2014 and December 31, 2013	8,780	8,780
Additional paid-in-capital	167,494	167,494
Retained earnings	219,189	201,680
Total common stockholder's equity	395,463	377,954
Total Liabilities and Common Stockholder's Equity	\$ 1,196,617	\$ 1,165,746