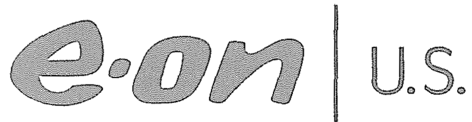

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Mr. Jeff DeRouen
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, KY 40601

RECEIVED
OCT 27 2010
PUBLIC SERVICE COMMISSION

October 27, 2010

Re: ***The Application of PPL Corporation, E.ON AG, E.ON US Investments Corp., E.ON U.S. LLC, Louisville Gas and Electric Company and Kentucky Utilities Company for Approval of an Acquisition of Ownership and Control of Utilities***
Case No. 2010-00204

Dear Mr. DeRouen:

Pursuant to the Commission's Order of September 30, 2010 in the above-referenced proceeding and in accordance with ordering paragraph No. 2, enclosed is a copy of the order issued on October 26, 2010 by the Federal Energy Regulatory Commission as noted below.

Exhibit 1 – Docket No. EC10-77-000
Order Authorizing Acquisition of Securities and Disposition of Jurisdictional Facilities

Should you have any questions, please do not hesitate to contact me.

Sincerely,

Rick E. Lovekamp

133 FERC ¶ 61,083
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
John R. Norris, and Cheryl A. LaFleur.

PPL Corporation Docket No. EC10-77-000

E.ON U.S. LLC

ORDER AUTHORIZING ACQUISITION OF SECURITIES AND DISPOSITION OF JURISDICTIONAL FACILITIES

(Issued October 26, 2010)

1. PPL Corporation (PPL) and E.ON U.S. LLC (E.ON U.S.) (collectively, Applicants), on behalf of their public utility subsidiaries, filed an application seeking authorization under sections 203(a)(1)(A), 203(a)(1)(B), and 203(a)(2) of the Federal Power Act (FPA)[1] for a proposed transaction in which PPL would acquire all of the issued and outstanding limited liability company interests of E.ON U.S. The Commission has reviewed the application under the Commission's Merger Policy Statement.[2] As discussed below, we will authorize the proposed transaction as consistent with the public interest.

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[1] 16 U.S.C. § 824b (2006).

[2] *See Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement*, Order No. 592, FERC Stats. & Regs. ¶ 31,044 (1996), *reconsideration denied*, Order No. 592-A, 79 FERC ¶ 61,321 (1997) (Merger Policy Statement). *See also FPA Section 203 Supplemental Policy Statement*, 72 Fed. Reg. 42,277 (Aug. 2, 2007), FERC Stats. & Regs. ¶ 31,253 (2007) (Supplemental Policy Statement). *See also Revised Filing Requirements Under Part 33 of the Commission's Regulations*, Order No. 642, FERC Stats. & Regs. ¶ 31,111 (2000), *order on reh'g*, Order No. 642-A, 94 FERC ¶ 61,289 (2001). *See also Transactions Subject to FPA Section 203*, Order No. 669, FERC Stats. & Regs. ¶ 31,200 (2005), *order on reh'g*, Order No. 669-A, FERC Stats. & Regs. ¶ 31,214, *order on reh'g*, Order No. 669-B, FERC Stats. & Regs. ¶ 31,225 (2006).

I. Background

A. Description of the Parties

2. PPL is a holding company under the Public Utility Holding Company Act of 2005 (PUHCA 2005).[3] Its direct wholly-owned subsidiary, PPL Electric Utilities Corporation (PPL Electric), owns transmission facilities located within the PJM Interconnection, L.L.C. (PJM) balancing area authority, and serves approximately 1.4 million customers in eastern and central Pennsylvania. PPL Electric has no captive wholesale or retail customers, but is the default supplier for retail customers within its service territory.[4] PPL also indirectly owns PPL EnergyPlus, LLC (PPL EnergyPlus), a power marketer authorized to sell energy, capacity and certain ancillary services at market-based rates,[5] and 16 other subsidiaries that are engaged in ownership and operation of generating facilities in PJM, ISO New England, or the state of Montana. These 16 subsidiaries are all exempt wholesale generators (EWG) that have been granted market-based rate authority.

3. E.ON U.S. is a holding company under PUHCA 2005, and an indirect, wholly-owned subsidiary of E.ON AG, a German corporation. E.ON U.S. directly and indirectly owns several public utility subsidiaries, as follows: Louisville Gas & Electric Company (LG&E), Kentucky Utilities Company (KU), LG&E Energy Marketing, Inc. (LEM), Electric Energy Inc. (EEInc), and Midwest Electric Power, Inc. (MEPI). LG&E is a public utility that owns and operates electric generation, transmission and distribution facilities, as well as natural gas distribution, transmission, and storage facilities, in Kentucky and Indiana. KU is a public utility that owns and operates electric generation, transmission, and distribution facilities in Kentucky, with limited operations in Tennessee and Virginia. LG&E and KU directly own approximately 8,273 MW of generation capacity and serve approximately 941,000 electric customers. LG&E and KU have authority to engage in wholesale sales of capacity and energy at market-based rates outside of the LG&E/KU and Big River Electric Corp. (BREC) balancing authority areas. Under the terms set by the Commission in approving their withdrawal from the Midwest

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[3] 42 U.S.C. § 16451 et seq. (2006).

[4] *See PPL Elec. Utils. Corp.*, Docket No. ER00-1712-010, *et al.* (Mar. 25, 2009) (letter order).

[5] *PP&L EnergyPlus Co.*, 85 FERC ¶ 61,377 (1998), *reh'g denied, PP&L EnergyPlus Co.*, 95 FERC ¶ 61,154 (2001); *PP&L EnergyPlus, Co., LLC,* Docket No. ER99-3779-000 (Aug. 30, 1999) (letter order); *PPL Elec. Utils. Corp.*, 125 FERC ¶ 61,075 (2008).

Independent Transmission System Operator, Inc. (Midwest ISO),[6] LG&E and KU contracted with Southwest Power Pool (SPP) and Tennessee Valley Authority (TVA) to serve as an independent transmission organization (ITO) and reliability coordinator, respectively, of their electric transmission facilities. Applicants indicate that LG&E and KU will soon be entering into a revised ITO agreement with SPP for an additional two years beyond September 1, 2010.[7]

4. LEM is a power marketer that does not own any generation facilities, but does have on file with the Commission a tariff for the sale of wholesale capacity and energy at market-based rates outside the LG&E/KU and BREC balancing areas.[8] Applicants state that LEM does not presently engage in any Commission-jurisdictional power sales.

5. KU owns a 20 percent interest in EEInc. EEInc owns and operates a six-unit coal-fired generating facility located in Joppa, Illinois, with a capacity of approximately 1,002 MW, and 55 miles of electric transmission lines that interconnect its generation facilities to the transmission lines of LG&E, KU, and TVA. EEInc's wholly-owned subsidiary, Midwest Electric Power, Inc., owns and operates two gas turbines with a total capacity of approximately 74 MW. LG&E and KU also hold a combined 8.13 percent interest in Ohio Valley Electric Corporation (OVEC). OVEC and its wholly-owned subsidiary, Indiana-Kentucky Electric Corporation (IKEC), own, respectively, the 986 MW Kyger Creek Generating Facility located in Gallipolis, Ohio, and the 1,196 MW Clifty Creek Generating Facility located in Madison, Indiana.[9]

B. Description of the Transaction

6. In the transaction, PPL will acquire all of the issued and outstanding limited liability company interests of E.ON U.S. from E.ON AG's indirect, wholly-owned subsidiary, E.ON U.S. Investments Corp., for a purchase price of $7.625 billion, comprised of $2.062 billion in cash (subject to adjustment), the repayment of outstanding

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[6] *See Louisville Gas and Elec. Co., et al.*, 114 FERC ¶ 61,282 (2006).

[7] Application at 12. The Commission authorized the two-year extension and, in connection therewith, granted a limited waiver of its Standard of Conduct regulations, in *E.ON U.S. LLC*, 133 FERC ¶ 61,012 (2010).

[8] *LG&E Power Mktg., Inc.*, 68 FERC ¶ 61,247, *modified on other grounds,* 69 FERC ¶ 61,153 (1994).

[9] E.ON states that, since LG&E's and KU's combined ownership of OVEC is less than 10 percent, neither OVEC nor IKEC should be considered an affiliate or subsidiary of E.ON for purposes of the application. Application at 15.

debt of E.ON U.S., LG&E, and KU estimated at $4.638 billion, and the assumption of $925 million in tax-exempt bonds of LG&E and KU. PPL, E.ON U.S., LG&E, and KU have committed that LG&E and KU will not incur additional indebtedness, issue any additional securities, or pledge any assets of LG&E or KU to finance any part of the purchase price of the transaction. As a result of the transaction, E.ON U.S. will become a direct, wholly-owned subsidiary of PPL, and E.ON U.S.'s subsidiaries will become indirect, wholly-owned subsidiaries of PPL.[10]

II. Notice of Filing and Responsive Pleadings

7. Notice of the application was published in the *Federal Register*, 75 Fed. Reg. 41,843 (2010), with interventions and protests due on or before August 30, 2010. The Kentucky Public Service Commission (Kentucky Commission) filed a notice of intervention. BREC, the Illinois Municipal Electric Agency, and Exelon Corporation filed timely motions to intervene. Kentucky Municipals[11] and American Municipal Power, Inc. (AMP) filed timely motions to intervene and protests. On September 15, 2010, Applicants filed an answer to the protests noting that they had reached agreement with Kentucky Municipals and AMP, and Kentucky Municipals and AMP filed notices of withdrawal of their protests pursuant to Rule 216(a) of the Commission's Rules of Practice and Procedure.[12] In their answer, Applicants also request that the Commission act by October 15, 2010, in order to allow the transaction to close by October 31, 2010.

8. In their answer, Applicants stated that Applicants have reached an agreement with Kentucky Municipals and AMP to address concerns raised in their protests. Specifically, Applicants agree that the Commission, in approving the application, may rely upon any and all of the Applicants' representations and commitments referred to in the application, whether made to the Commission or to one or more of the states that have to approve the transaction. Further, Applicants affirm that they will honor all commitments, conditions and requirements related to prior Commission approvals of the merger of LG&E and KU and the withdrawal of LG&E and KU from the Midwest ISO in accordance with the specific terms of those commitments, including the commitment not to charge wholesale requirements customers Independent Transmission Organization and Reliability Coordinator costs absent a filing pursuant to section 205 of the FPA. Applicants agree

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[10] Application at 17.

[11] Kentucky Municipals consists of the Kentucky municipal requirements customers of KU, Owensboro Municipal Utilities, and Kentucky Municipal Power Agency and its members.

[12] 18 C.F.R. § 385.216(a) (2010)

that they will honor all existing contracts. Applicants also agree not to seek to recover from customers receiving wholesale energy or transmission service from any subsidiary of Applicants, or to include in formula rates charges to any such customers, any costs of the transaction that they have agreed not to recover from retail customers in Kentucky in the proceeding before the Kentucky Commission in Case No. 2010-00204 (e.g., transaction costs, costs to achieve savings, and management retention bonuses). Applicants also agree to facilitate advisory group meetings to solicit input regarding LG&E's and KU's plan for addressing the expiration of the ITO agreement with SPP after the two-year extension authorized in Docket No. ER10-2157-000,[13] to continue the ongoing working group process for exploring tariff modifications to address interconnection delays, and to file any tariff modifications that result from that process. Applicants state that KU's wholesale contracts with identified customers provide that KU can deliver written notice of termination of those contracts no earlier than January 1, 2011, to become effective January 1, 2016. Applicants agree that KU will not provide such notice any earlier than January 1, 2012, to become effective January 1, 2017. Finally, the Applicants agree to file any orders issued by other regulatory bodies regarding the proposed transaction under 18 C.F.R. § 33.2(i), even if such orders are issued after the issuance of a Commission order approving the application.

III. Discussion

A. Procedural Issues

9. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,[14] the notice of intervention and timely, unopposed motions to intervene serve to make the entities that filed them parties to this proceeding. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure[15] prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept Applicants' answer because it has provided information that assisted us in our decision-making process.

B. Standard of Review Under Section 203

10. Section 203(a)(4) requires the Commission to approve a transaction if it determines that the transaction will be consistent with the public interest. The Commission's analysis of whether a transaction will be consistent with the public interest

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[13] *See supra* note 7.

[14] 18 C.F.R. § 385.214 (2010).

[15] 18 C.F.R. § 385.213(a)(2) (2010).

generally involves consideration of three factors: (1) the effect on competition; (2) the effect on rates; and (3) the effect on regulation.[16] Section 203 also requires the Commission to find that the transaction "will not result in cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company, unless the Commission determines that the cross-subsidization, pledge, or encumbrance will be consistent with the public interest."[17] The Commission's regulations establish verification and informational requirements for applicants that seek a determination that a transaction will not result in inappropriate cross-subsidization or a pledge or encumbrance of utility assets.[18]

C. Analysis Under Section 203

1. Effect on Competition – Horizontal Market Power

a. Applicants' Analysis

11. Applicants state that the transaction will have no adverse effect on horizontal competition. They state that the Commission has previously found that even though a market is highly concentrated, as are the LG&E/KU and Eastern Kentucky Power Cooperative (Eastern Kentucky) balancing authority areas, if a proposed transaction does not eliminate a competitor in that market, there is no adverse impact on competition.[19] Applicants state that PPL has not historically made sales into the LG&E/KU balancing authority area or the adjacent Eastern Kentucky balancing authority area and, therefore, the transaction will not eliminate a competitor in these balancing authority areas and will not have an adverse impact on competition in these markets.

12. Applicants further assert that most of LG&E's and KU's generation is committed to serving their native load and wholesale requirements customers and that LG&E and KU make only limited sales into PJM, where most of PPL's generation is located. Applicants also state that PPL's and E.ON U.S.'s public utility subsidiaries' sales into the Midwest ISO market constitute an insignificant market share. Applicants conclude that any horizontal overlap between the wholesale power sales of E.ON U.S.'s public utility

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[16] *See* Merger Policy Statement, FERC Stats. & Regs. at 30,111.

[17] 16 U.S.C. § 824b(a)(4) (2006).

[18] 18 C.F.R. § 33.2(j) (2010).

[19] Application at 19 (citing *Duke Energy Corp., et al.,* 113 FERC ¶ 61,297, at P 83 (2005)).

subsidiaries and PPL's public utility subsidiaries is *de minimis* and, therefore, the transaction has no meaningful impact on market concentration.[20]

13. Notwithstanding such *de minimis* horizontal overlap, Applicants submitted the results of a competitive analysis screen for the LG&E/KU balancing authority area, the PJM market, the Eastern Kentucky balancing authority area, and the Midwest ISO market. Applicants state that there were no screen failures for either Economic Capacity or Available Economic Capacity for any market under any demand conditions studied.[21] Applicants state that their analysis confirms their conclusion that the transaction presents no horizontal competitive concerns.[22] For the Eastern Kentucky balancing authority area, the greatest Herfindahl-Hirschman Index (HHI) change for Available Economic Capacity in a moderately concentrated market (post-transaction HHI is 1,035) is 61 points. For the LG&E/KU balancing authority area, the greatest HHI change for Available Economic Capacity in a concentrated market (post-transaction HHI is 1,975) is 45 points.

b. Commission Determination

14. Applicants have demonstrated that the effect of combining their operations in the relevant geographic markets is *de minimis*. Moreover, the transaction will not eliminate a competitor or materially increase market concentration in the relevant markets. We note that no protester has argued otherwise. Therefore, we find that the proposed transaction does not raise horizontal market power concerns.

2. Effect on Competition – Vertical Market Power

a. Applicants' Analysis

15. Applicants assert that the transaction does not raise any vertical market power concerns. They state that PPL Electric, LG&E, KU, and EEInc provide transmission service under Commission-approved open access transmission tariffs (OATT)[23] and will

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[20] Application at 18-19.

[21] *Id.* at 22-26. Each supplier's "Economic Capacity" is the amount of capacity that could compete in the relevant market given market prices, running costs, and transmission availability. "Available Economic Capacity" is based on the same factors but subtracts the suppliers' native load obligation from its capacity and adjusts transmission availability accordingly.

[22] Application at 21.

[23] *Id.* at 27.

continue to do so after consummation of the transaction. Applicants add that PJM will continue to direct the operations of PPL Electric's transmission facilities and provide transmission service under the PJM OATT. Applicants further state that SPP will continue to act as the ITO with respect to transmission service over LG&E's and KU's facilities.[24]

16. Applicants argue that LG&E's ownership of natural gas distribution systems and storage facilities does not raise any vertical market power concerns. Applicants state that LG&E's natural gas distribution systems and storage facilities are not connected with nor are they used to serve any non-affiliated gas-fired generation facilities. Applicants also state that PPL is the indirect owner of PPL Interstate Energy Company (Interstate), which owns and operates an intrastate natural gas and oil distribution system that primarily serves the Martins Creek Steam Electric Station, which is owned by PPL. Applicants argue that the transaction cannot allow them to exercise vertical market power as a result of Interstate's ownership of this facility, because the system is regulated by the Pennsylvania Public Utilities Commission (Pennsylvania Commission) as a common carrier pipeline.[25] Applicants argue further that neither EEInc's ownership of a 3.9 mile rail line, which is used to support deliveries of coal to its own facilities, nor LG&E and KU's ownership and leasing of rail cars, which are also used to support deliveries of coal to their own facilities, raise any vertical market power issues, and that the transaction will not provide Applicants with any ability to erect barriers to market entry.[26]

b. <u>Commission Determination</u>

17. In transactions combining electric generation assets with inputs to generating power (such as natural gas, transmission, or fuel), competition can be harmed if the transaction increases a firm's ability or incentive to exercise vertical market power in wholesale electricity markets. For example, by denying rival firms access to inputs or by raising their input costs, a post-transaction firm could impede entry of new competitors or inhibit existing competitors' ability to undercut an attempted price increase in the downstream wholesale electricity market. Here, as discussed below, Applicants have shown that the proposed transaction does not raise any of these concerns.

18. We find that Applicants' ownership of transmission facilities does not lead to any concerns about transmission-related vertical market power because Applicants have turned over control of their transmission facilities to independent entities, eliminating

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[24] *Id.* at 27-28.

[25] *Id.* at 28-29.

[26] *Id.* at 29-30.

their ability to use its transmission system to harm competition. In a number of cases, we have stated that both the ability and incentive to exercise vertical market power are necessary for a transaction to harm competition.[27]

19. Similarly, Applicants have shown that the combination of natural gas transportation, coal delivery, and electric generation assets will not harm competition. Applicants will not be able to favor their own generation, raise rivals' costs, or otherwise disadvantage rivals because: (1) LG&E's natural gas distribution systems and storage facilities are not connected with nor are they used to serve any non-affiliated gas-fired generation facilities, (2) Interstate's facilities are regulated by the Pennsylvania Commission as a common carrier pipeline, and (3) EEI's, LG&E's and KU's rail and railcar facilities are used only to support deliveries of coal to their own facilities. Applicants have also shown that there are no other barriers to entry that would raise vertical market power concerns. We note that no protester raised vertical market power issues in this proceeding.

3. **Effect on Rates**

a. **Applicants' Analysis**

20. Applicants state that the proposed transaction will have no adverse effect on rates. They also commit to hold transmission and wholesale customers harmless from costs related to the transaction for a period of five years to the extent that such costs exceed savings related to the transaction.[28]

21. Applicants argue that neither PPL nor any of its affiliates have captive wholesale or retail power customers. Applicants maintain that because all contracts under which PPL's public utility subsidiaries provide wholesale power service are entered into pursuant to market-based rate authority, these contracts cannot impose any costs related to the transaction upon wholesale customers.

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[27] *See, e.g.*, *National Grid plc and KeySpan Corp.*, 117 FERC ¶ 61,080, at P 45 (2006) (*National Grid*); *American Electric Power Co.*, 90 FERC ¶ 61,242, at 61,788 (2000), *review denied sub nom. Wabash Valley Power Assn. v. FERC*, 268 F.3d 1105 (D.C. Cir. 2001). *See also* Order No. 642, FERC Stats. & Regs. at 31,911.

[28] Application at 31. As noted above, LG&E and KU have agreed with Kentucky Municipals and AMP that they will not seek to recover from customers receiving wholesale energy or transmission service from any subsidiary of the Applicants, or to include in any formula rates charged to any such customers, any costs of the transaction that they have agreed not to seek to recover from retail customers in Kentucky (e.g., transaction costs, costs to achieve savings, and management retention bonuses).

22. Applicants state that E.ON's public utility subsidiaries provide wholesale power service under a variety of contract types. First, they state that KU sells wholesale power to certain municipal utilities under long-term agreements which establish cost-based wholesale power rates based on a formula rate on file with the Commission. Applicants submit that transparent formula rates enable the Commission to enforce the Applicants' hold harmless commitment to prevent the passthrough to customers of costs related to the transaction.

23. Second, Applicants state that LG&E and KU sell short-term wholesale power under agreements entered into under the terms of a cost-based rate tariff for short-term energy sales.[29] They state that the prices for these sales, which are generally spot in nature, are capped at 110 percent of the LG&E/KU system incremental cost. Applicants submit that customers under these agreements are shielded from any rate effects of the transaction because the rates for these sales are negotiated (subject to the cap) and the costs related to the transaction do not factor into calculation of the cap.

24. Third, LG&E and KU also sell wholesale power pursuant to contracts entered into under their respective market-based rate tariffs. Applicants add that EEInc presently sells wholesale power exclusively at market-based rates. Applicants argue that insofar as such sales are market-based in nature, LG&E, KU and EEInc cannot impose any costs related to the transaction on their customers and therefore these wholesale power customers are shielded from any adverse rate effects of the transaction.[30]

25. Applicants argue that the transaction will have no adverse effect on the transmission service rates of the Applicants' transmission-owning public utilities, which provide transmission service under their applicable OATTs. Applicants note that PPL Electric, LG&E, and KU provide transmission service at formula rates in accordance with their respective OATTs and argue that the transparency of these formula rates, combined with Commission oversight, ensures that the Applicants' hold harmless commitment will be honored and transaction-related costs will not be passed through to transmission customers. Applicants note that transaction-related costs also cannot automatically be passed through into EEInc's transmission rates because EEInc provides only firm and non-firm point-to-point transmission service at stated rates.[31]

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[29] *See* LG&E/KU Revised Cost-Based Tariff Sheets, Docket No. ER06-1438-000 (filed Nov. 3, 2006).

[30] Application at 32-33.

[31] *Id.* at 34.

b. Commission Determination

26. We find that the transaction will have no adverse effect on rates. With respect to transaction-related costs, we accept Applicants' commitment to hold transmission and wholesale customers harmless from costs related to the transaction for a period of five years to the extent that such costs exceed savings related to the transaction, which we interpret to include all transaction-related costs, not only costs related to consummating the transaction. We note that nothing in the application indicates that rates to customers will increase as a result of the transaction, and no customer argues otherwise. In addition, the Commission will be able to monitor the Applicants' hold harmless provision under its authority under section 301(c) of the FPA and the books and records provision of PUHCA 2005, and the commitment is fully enforceable based on the Commission's authority under section 203 of the FPA.

27. If Applicants seek to recover transaction-related costs through their wholesale power or transmission rates they must submit a compliance filing that details how they are satisfying the hold harmless requirement. If Applicants seek to recover transaction-related costs in an existing formula rate that allows for such recovery, then that compliance filing must be filed in the section 205 docket in which the formula rate was approved by the Commission, as well as in the instant section 203 docket.[32] We also note that, if Applicants seek to recover transaction-related costs in a filing whereby they are proposing a *new* rate (either a new formula rate or a new stated rate), then that filing must be made in a *new* section 205 docket as well as in the instant section 203 docket.[33] The Commission will notice such filings for public comment. In such filings, Applicants must: (1) specifically identify the transaction-related costs they are seeking to recover, and (2) demonstrate that those costs are exceeded by the savings produced by the transaction, in addition to any requirements associated with filings made under section 205. Such a hold harmless commitment will protect customers' wholesale power and transmission rates from being adversely affected by the proposed transaction.

4. Effect on Regulation

a. Applicants' Analysis

28. Applicants assert that the transaction will not diminish the Commission's jurisdiction or affect the jurisdiction of state regulatory authorities.[34] In fact, Applicants

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[32] In this case the filing would be a compliance filing in both the section 203 and 205 dockets.

[33] In this case the filing would be a compliance filing in the section 203 docket, but a rate application in the section 205 docket.

[34] *Id.* at 44.

argue that the transaction will result in increased federal regulatory authority over the Applicants and their affiliates because PPL will no longer enjoy the waiver from certain of the Commission's regulations under PUHCA 2005 inasmuch as it will no longer qualify as a single-state holding company.[35] Applicants further state that E.ON U.S., LG&E, KU, and E.ON Services, Inc. will remain subject to the same regulations after the transaction, and that the public utility subsidiaries of PPL and E.ON will remain subject to the Commission's jurisdiction and regulations under the FPA to the same extent that they are currently regulated.[36]

29. Applicants argue that the transaction will have no adverse effect on state regulation because PPL Electric will remain subject to regulation by the Pennsylvania Commission to the same extent that it is currently regulated, and LG&E and KU will remain subject to regulation by the Kentucky Commission, the Virginia State Corporation Commission (Virginia Commission) and the Tennessee Regulatory Authority (Tennessee Authority) to the same extent they are currently regulated.[37]

b. Commission Determination

30. We find that neither state nor federal regulation will be impaired by the proposed transaction. The Commission's review of a transaction's effect on regulation focuses on ensuring that it does not result in a regulatory gap at the federal or state level.[38] We find that the transaction will not create a regulatory gap at the federal level, because the Commission will retain its regulatory authority over the companies after the transaction. In the Merger Policy Statement, the Commission stated that it ordinarily will not set the issue of the effect of a transaction on state regulatory authority for a trial-type hearing where a state has authority to act on the transaction. However, if the state lacks this authority and raises concerns about the effect on regulation, the Commission stated that it may set the issue for hearing, and that it will address such circumstances on a case-by-case basis.[39] We note that no party alleges that regulation would be impaired by the proposed transaction, and no state commission has requested that the Commission address the issue of the effect on state regulation.

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[35] *Id.* at 35 (citing 18 C.F.R. § 366.3(c)(1)).

[36] Application at 35.

[37] *Id.* at 36.

[38] Merger Policy Statement, FERC Stats. & Regs. at 30,124.

[39] *Id.* at 30,125.

5. Cross-subsidization

a. Applicants' Analysis

31. Applicants assert that the proposed transaction will not result in, at the time of the proposed transaction or in the future, cross-subsidization of a non-utility associate company or the pledge or encumbrance of utility assets for the benefit of an associate company. Applicants verify that the transaction will not result in:

a. any transfer of facilities between a traditional utility associate company that has captive customers or that owns or provides transmission service over jurisdictional facilities, and an associate company, because the transaction will not result in any transfer of jurisdictional facilities between affiliated entities.

b. any new issuances of securities by a traditional public utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, for the benefit of an associate company. Applicants state that although LG&E and KU will each issue certain debt securities as a result of the transaction, doing so will not benefit any associate company of LG&E or KU.

c. any new pledge or encumbrance of assets of a traditional public utility associate company that has captive customers or that provides transmission service over jurisdictional transmission facilities, for the benefit of an associate company. Applicants state that although each of LG&E and KU will issue certain debt as a result of the transaction, such issuance will be only for the purpose of refinancing existing debt and thus should not be considered by the Commission as a new pledge or encumbrance.

d. any new affiliate contract between a non-utility company and a traditional public utility associate company that has captive customers or that owns or provides transmission service over jurisdictional transmission facilities, other than non-power goods and services agreements subject to review under sections 205 and 206 of the FPA.[40] Applicants state that the replacement of certain existing debt of LG&E and KU with unsecured debt issued to a PPL affiliate, and, subsequently, the issuance of LG&E and KU first mortgage bonds,

[40] Application Exhibit M at 1-5.

> are subject to approval by the Kentucky Commission, the Virginia Commission and the Tennessee Authority. Applicants add that other than transactions involving centralized service companies subject to regulation under PUHCA 2005, the transaction will not result in any new affiliate contract between PPL Electric, LG&E, KU, and any associate company.[41]

Further, Applicants and their affiliates disclose their existing pledges and encumbrances of utility assets, as required under Order No. 669-A and 18 C.F.R. § 33.2(j)(1).[42]

32. Applicants add that the Kentucky Commission, the Virginia State Corporation Commission and the Tennessee Regulatory Authority each has measures, including statutory and regulatory authority and/or commitments by LG&E and KU or PPL Electric, respectively, to protect customers against inappropriate cross-subsidization of a non-utility associate company or the encumbrance of utility assets for the benefit of an associate company.[43]

b. Commission Determination

33. Based on the facts as presented in the application, we find that the transaction will not result in cross-subsidization or the pledge or encumbrance of utility assets for the benefit of an associate company. We note that no party has argued otherwise.

34. When a controlling interest in a public utility is acquired by another company, whether a domestic company or a foreign company, the Commission's ability to adequately protect public utility customers against inappropriate cross-subsidization may be impaired unless it has access to the acquirer's books and records. Section 301(c) of the FPA gives the Commission authority to examine the books and records of any person who controls, directly or indirectly, a jurisdictional public utility insofar as the books and records relate to transactions with or the business of such public utility. The approval of this transaction is based on such ability to examine books and records.

D. Accounting Analysis

35. Applicants propose to account for the transaction as a business combination using the purchase method of accounting. Applicants state that generally accepted accounting

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[41] Application Exhibit M at 2-4.

[42] *Id.* at 6-7.

[43] Application at 38.

principles (GAAP) for business combinations require that most assets and liabilities, whether they are on the balance sheet or off the balance sheet, be measured and recorded at fair value as of the date when control transfers to the new owner. For purposes of measuring the fair value of the regulated assets acquired and certain regulated liabilities assumed, Applicants state that they assumed the fair value to be equal to net book value. Applicants, however, measured the fair value of KU's 20 percent investment in EEInc and KU's and LG&E's long-term debt at amounts above net book value.

36. The proposed accounting records KU's fair value adjustment to its investment in EEInc by debiting Account 123.1, Investment in Subsidiary Companies, and crediting Account 211, Miscellaneous Paid-in Capital, for $84.9 million. To recognize fair value adjustments to long-term debt, Applicants propose to make entries to the books of LG&E and KU to credit Account 221, Bonds, for $282,000 and $6.3 million, respectively, with offsetting amounts recorded to Account 186, Miscellaneous Deferred Debits. Applicants also propose to amortize the fair value adjustments in Account 221 and Account 186 to interest expense, thus resulting in no net impact to interest expense. Applicants state that for business combinations, GAAP requires debt to be measured and recorded at fair value as of the date when control transfers to the new owner, with the fair value adjustment amortized to interest expense over the life of the debt.[44]

37. Applicants also propose to push-down $238 million of goodwill to LG&E and $379 million of goodwill to KU by debiting Account 186 and crediting Account 211. Applicants state that its commitment not to reflect any costs associated with the transaction in wholesale or retail rates extends to the impact of any adjustments to Account 211 on the calculation of the allowance for funds used during construction. Finally, Applicants note that transaction costs are immediately expensed by PPL and will not be included on LG&E's and KU's books.

38. We accept the proposed accounting to account for the transaction as a business combination under GAAP and recognize the carrying value of most of LG&E's and KU's regulated assets and liabilities as their fair value. We also find the proposed accounting for goodwill to be consistent with prior guidance addressing the accounting for business combinations using the purchase method of accounting.[45] However, the proposed accounting for the fair value adjustment to long-term debt is not consistent with the

[44] *See* Appendix 4, Proposed Accounting Entries.

[45] *Startrans IO, L.L.C.,* 122 FERC ¶ 61,307 (2008); *Great Plains Energy Incorporated*, 121 FERC ¶ 61,069 (2007), *reh'g denied*, 122 FERC ¶ 61,177 (2008); *Michigan Electric Transmission Company, LLC*, Docket No. AC03-9-000 (February 5, 2004) (unpublished letter order).

Commission's Uniform System of Accounts or GAAP in certain respects. First, only the face value of issued bonds can be recorded in Account 221. Therefore, the fair value adjustment to debt should be recorded in Account 224, Other Long Term Debt, which provides for other debt not otherwise provided for. Second, the offsetting entry to the adjustment to long-term debt should have been recognized as a reduction of equity and charged to Account 211, rather than Account 186. Lastly, the amortization of the fair value adjustment should be recorded as a credit to interest expense, without offset, over the life of the debt that the fair value adjustment pertains to and flowed through to net income as provided for under GAAP. We will therefore require LG&E and KU to revise their proposed accounting for the fair value debt adjustment to reflect the above noted adjustments. We recommend LG&E and KU record the fair value adjustment and the related amortization to interest expense using a separate sub-account of Account 224 and Account 427, Interest on Long-Term Debt, respectively. Further, LG&E and KU must disclose in the notes to the financial statements of their FERC Form No. 1 the nature and amount of the fair value adjustment to long-term debt and the related amortization to interest expense.

39. In addition, the Commission generally requires public utilities to maintain detailed accounting records associated with its push-down accounting so as to facilitate the evaluation of the effects of the transaction on common equity and other accounts in future periods if needed for ratemaking purposes.[46] Consequently, we will require the applicants to maintain detailed accounting records associated with its push-down accounting. Applicants should consider the use of separate sub-accounts for maintaining the required information.

40. We also direct LG&E and KU to submit their proposed final accounting to the Commission for approval within six months after the acquisition is consummated.[47] The accounting submission should provide all acquisition-related accounting entries made to the books and records of LG&E and KU, along with appropriate narrative explanations describing the basis for the entries.

E. <u>Other Considerations</u>

41. Information and/or systems connected to the bulk power system involved in this transaction may be subject to reliability and cyber security standards approved by the

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[46] *Michigan Electric Transmission Company, LLC and Midwest Independent Transmission System Operator, Inc.*, 116 FERC ¶ 61,164 (2006); *Niagara Mohawk Holdings Inc.*, 95 FERC ¶ 61,381 (2001), *reh'g denied*, 96 FERC ¶ 61,144 (2001).

[47] Electric Plant Instruction No. 5, Electric Plant Purchased or Sold, and Account 102, Electric Plant Purchased or Sold, 18 CFR Part 101 (2010).

Commission pursuant to FPA section 215. Compliance with these standards is mandatory and enforceable regardless of the physical location of the affiliates or investors, information databases, and operating systems. If affiliates, personnel or investors are not authorized for access to such information and/or systems connected to the bulk power system, a public utility is obligated to take the appropriate measures to deny access to this information and/or the equipment/software connected to the bulk power system. The mechanisms that deny access to information, procedures, software, equipment, etc., must comply with all applicable reliability and cyber security standards. The Commission, North American Electric Reliability Corporation or the relevant regional entity may audit compliance with reliability and cyber security standards.

The Commission orders:

(A) The proposed transaction is hereby authorized, as discussed in the body of this order.

(B) Applicants must inform the Commission within 30 days of any material change in circumstances that departs from the facts the Commission relied upon in granting the application.

(C) The foregoing authorization is without prejudice to the authority of the Commission or any other regulatory body with respect to rates, service, accounts, valuation, estimates or determinations of costs, or any other matter whatsoever now pending or which may come before the Commission.

(D) Nothing in this order shall be construed to imply acquiescence in any estimate or determination of cost or any valuation of property claimed or asserted.

(E) The Commission retains authority under sections 203(b) and 309 of the FPA to issue supplemental orders as appropriate.

(F) Applicants shall make any appropriate filings under section 205 of the FPA, as necessary, to implement the proposed transaction.

(G) Applicants shall adhere to the accounting requirements discussed in the body of the order.

(H) Applicants must submit their proposed final accounting within six months after the acquisition is consummated. The accounting submission should provide all acquisition-related accounting entries made to the books and records of LG&E and KU, along with appropriate narrative explanations describing the basis for the entries.

(I) If Applicants seek to recover transaction-related costs through their wholesale power or transmission rates, they must first submit a compliance filing in this docket that details how they are satisfying the hold harmless requirement. In particular, in such a filing, Applicants must: (1) specifically identify the transaction-related costs they are seeking to recover; and (2) demonstrate that those costs are exceeded by the savings produced by the transaction.

(J) Applicants shall notify the Commission within 10 days of the date on which the transaction is consummated.

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.