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COMMISSION

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Dianne B. Kuhnell,  
Senior Paralegal

VIA OVERNIGHT DELIVERY

December 5, 2008

Ms. Stephanie Stumbo  
Executive Director  
Kentucky Public Service Commission  
211 Sower Boulevard  
Frankfort, Kentucky 40602-0615

Re: Application of Duke Energy Kentucky, Inc. for an Order Authorizing the Issuance of Unsecured Dept and Long-Term Notes, Execution and Delivery of Long-Term Loan Agreement, and Use of Interest Rate Management Instruments  
Case No. 2008-

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and

✓ 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. 2008- 00504

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Dear Ms. Stumbo:

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

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

If you have any questions regarding this filing, please call me at (513) 419-1837.

Sincerely,

Dianne Kuhnell  
Senior Paralegal

cc: Hon. Dennis E. Howard II (via overnight w/encl.)

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DEC 08 2008

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 )  
Obligations )

Case No. 2008- 00504

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APPLICATION FOR CAPITAL LEASE AUTHORITY

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Pursuant to KRS 278.300 and 807 KAR 5:001 Sections 8 and 11, 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. **Address:** Duke Energy Kentucky is a Kentucky corporation with its principal place of business at 1697A Monmouth Street, Newport Shopping Center, Newport, Kentucky 41071. Duke Energy Kentucky's principal executive office is 139 East Fourth Street, Cincinnati, Ohio 45202.

2. **Articles of Incorporation:** Pursuant to 807 KAR 5:001, Section 8(3), Duke Energy Kentucky states that a certified copy of its Articles of Incorporation, as amended, on file with this Commission in Case No. 2006-563 and is hereby incorporated by reference.

3. **Statement of Business:** Duke Energy Kentucky is a utility as defined in KRS 278.010(3)(a) and (b), engaged in providing retail gas and electric services 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.

4. **807 KAR 5:001 Section 11(1)(a).** As of September 30, 2008, the original cost of Duke Energy Kentucky's property was \$1,535,987,000. The Company's principal properties consist of electric generating plants, and gas and electric distribution facilities.

5. **807 KAR 5:001 Section 11(1)(b).** 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, 2010, 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.

6. **807 KAR 5:001 Section 11(1)(c).** The proceeds from the Capital Lease obligations are expected to be used: (a) for necessary acquisitions of property, and estimated capital expenditures of approximately \$80 million in 2009 and \$99 million in 2010; (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.

7. **807 KAR 5:001 Section 11(1)(d).** 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 Case No. 2006-562. 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.

8. **807 KAR 5:001 Section 11(1)(e).** This section is not applicable, since no specific discharge of obligations is contemplated at this time from transacting the Capital Leases.

9. **807 KAR 5:001 Section 11(1)(f).** In Case No. 2006-00562, the Commission approved up to \$25 million in principal amount of Capital Lease obligations for the period ending December 31, 2008. As of September 30, 2008, there remained approximately \$21.9 million of available authority.

10. **807 KAR 5:001 Section 6 and Section 11(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	6 and 11 (2) (a)
1	Amount and kinds of stock authorized	6 (1)
1	Amount and kinds of stock issued and outstanding	6 (2)
1	Terms of preference or preferred stock	6 (3)
1	Brief description of each mortgage on property of ULH&P	6 (4)
1-2	Amount of bonds authorized and issued and related information	6 (5)
3	Notes outstanding and related information	6 (6)
3	Other indebtedness and related information	6 (7)
4	Dividend information	6 (8)
4	Detailed Income Statement and Balance Sheet	6 (9)




10. **807 KAR 5:001 Section 11(2)(b).** This section is not applicable, as there are no related deeds of trust or mortgage documents relevant to this application.

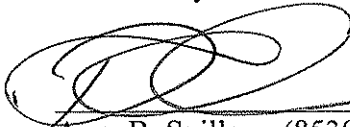
11. **807 KAR 5:001 Section 11(2)(c).** The proposed construction is primarily comprised of installations, improvements and extensions in the ordinary course of business as a utility. It is therefore impractical to submit maps and plans pertaining thereto.

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 Attorney:


  
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Amy B. Spiller (85309)  
Associate General Counsel  
Rocco O. D'Ascenzo  
Senior Counsel (92796)  
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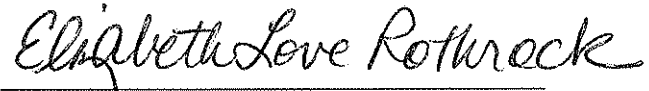
VERIFICATION

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 Kentucky, Inc.; 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 2nd day of December, 2008.

  
\_\_\_\_\_  
Notary Public

My Commission Expires: 12/7/2008

**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)

Gas Department	2009	2010	2011
Gas Production	\$ 132	\$ 135	\$ 126
Gas Special Projects	20,234	17,668	334
Gas Distribution	13,109	12,851	12,353
Gas Building & Grounds	173	177	186
Gas Meters	1,741	1,771	1,661
<b>Total Gas Department</b>	<b>\$ 35,388</b>	<b>\$ 32,602</b>	<b>\$ 14,660</b>
Electric Department	2009	2010	2011
Substations - Transmission	\$ 416	\$ 416	\$ 319
Substations - Distribution	560	4,466	829
Transmission Lines	276	279	404
Distribution Transformers	1,578	1,600	1,629
Line Extensions	5,539	5,518	5,492
Street Lights	850	862	877
Distribution Improvements	8,707	5,883	9,460
Meters & Instrument Transform	557	564	575
Transportation	23	23	16
Production Plant	23,964	45,542	44,681
Environmental	1,742	1,477	9,980
<b>Total Electric Department</b>	<b>\$ 44,209</b>	<b>\$ 66,631</b>	<b>\$ 74,261</b>
Common Plant	2009	2010	2011
Buildings & Grounds	\$ 212	\$ 112	\$ 114
<b>Total Common Plant</b>	<b>\$ 212</b>	<b>\$ 112</b>	<b>\$ 114</b>
<b>Total Forecast Capital Expenditures</b>	<b>\$ 79,810</b>	<b>\$ 99,344</b>	<b>\$ 89,035</b>

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 September 30, 2008:

Capital Stock and Additional Paid-in Capital  
As of 9/30/2008  
(\$ per 1,000)

Capital Stock	\$8,780
Premiums thereon	23,760
Total Capital Contributions from Parent (since 2006)	3,673
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 of 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 two outstanding issues of unsecured senior debentures issued under an Indenture dated July 1, 1995 between itself and the The Bank of New York

Trust Company, N.A., as Trustee, (Successor Trustee to Fifth Third Bank), as supplemented by four Supplemental Indentures. The Indenture, as amended, allows the Company to issue debt securities in an unlimited amount from time to time. The Debentures issued under the Indenture are as follows:

Supplemental Indenture	Date of Issue	Principal Amount Authorized and Issued	Principal Amount Outstanding	Rate of Interest	Date of Maturity	Interest Paid Year 2007
2 <sup>nd</sup>	4/30/1998	20,000,000	20,000,000	6.500%	4/30/2008	1,300,000
Supplemental 4 <sup>th</sup>	9/17/1999	20,000,000	<u>20,000,000</u>	7.875%	9/15/2009	<u>1,575,000</u>
Supplemental			<u>40,000,000</u>			<u>2,875,000</u>

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 2007
Not Applicable	12/9/2004	40,000,000	40,000,000	5.000%	12/15/2014	2,000,000
1 <sup>st</sup>	3/10/2006	50,000,000	50,000,000	5.750%	3/10/2016	2,875,000
Supplemental 1 <sup>st</sup>	3/10/2006	65,000,000	<u>65,000,000</u>	6.200%	3/10/2036	<u>4,030,000</u>
Supplemental			<u>155,000,000</u>			<u>8,905,000</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. Duke Energy Kentucky has no outstanding notes other than the short term notes permitted under the terms of the Utility Money Pool Agreement approved by the Commission.

(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, 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 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 2007
Series 2006A	8/1/2006	50,000,000	50,000,000	3.89% <sup>(1)</sup>	8/1/2027	1,943,056
Series 2006B	8/1/2006	26,720,000	<u>26,720,000</u>	3.82% <sup>(1)(2)</sup>	8/1/2027	<u>1,020,704</u>
			<u>76,720,000</u>			<u>2,963,760</u>

<sup>(1)</sup> The interest rate represents the average floating-rate of interest on the bonds for 2007. The interest rate on the bonds resets every 35 days through an auction process.

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

**(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.**

Year Ending	Dividends per Share		No. of Shares	Par Value of Stock
	Per Share	Total		
December 31, 2003	\$10.77	6,304,036	585,333	8,779,995
December 31, 2004	24.94	14,600,000	585,333	8,779,995
December 31, 2005	17.03	9,965,521	585,333	8,779,995
December 31, 2006	0.00	0	585,333	8,779,995
December 31, 2007	0.00	0	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 September 30, 2008 and the detailed Balance Sheet as of September 30, 2008.



Duke Energy Kentucky  
Income Statement  
Twelve Months Ended September 30, 2008

<b>Operating Revenue</b>	
Electric	329,994,621
Gas	147,929,033
Other	22,323,330
<b>Total Operating Revenues</b>	<u>500,246,984</u>
<b>Operating Expenses</b>	
Natural Gas and Petroleum Products Purchased	104,922,995
Operations, Maintenance and Other	127,392,920
Fuel used in Electric Generation and Purchased Power	153,974,907
Depreciation and Amortization	37,366,439
Property and Other Taxes	10,001,235
<b>Total Operating Expenses</b>	<u>433,658,496</u>
<b>Operating Income</b>	<u>66,588,488</u>
<b>Other Income and Expenses</b>	
Other, Net	4,275,147
Interest Expense	16,349,074
<b>Earnings From Continuing Operations Before Income Taxes</b>	<u>54,514,561</u>
Income Tax Expense (Benefit) From Continuing Operations	18,590,091
<b>Net Income</b>	<u>35,924,470</u>

Duke Energy Kentucky  
Balance Sheet  
September 30, 2008

**ASSETS**

Cash and Cash Equivalents	82,807,415
Receivables	32,759,785
Inventory	41,789,879
Other	11,640,390
<b>Total Current Assets</b>	<b>168,997,469</b>

**Investments and Other Assets**

Intangibles, net	11,851,647
Other	2,886,632
<b>Total Investments and Other Assets</b>	<b>14,738,279</b>

**Property, Plant and Equipment**

Cost	1,535,987,666
Less Accumulated Depreciation and Amortization	(637,950,263)
<b>Net Property Plant and Equipment</b>	<b>898,037,403</b>

**Regulatory Assets and Deferred Debits**

Deferred Debt Expense	5,153,814
Other	19,324,023
<b>Total Regulatory Assets and Deferred Debits</b>	<b>24,477,837</b>

**Total Assets**

**1,106,250,988**

**LIABILITIES AND COMMON STOCKHOLDERS' EQUITY**

**Current Liabilities**

Accounts Payable	85,621,672
Taxes Accrued	15,047,588
Interest Accrued	1,826,181
Current Maturities of Long-Term Debt	22,546,564
Other	10,409,640
<b>Total Current Liabilities</b>	<b>135,451,645</b>

**Long-Term Debt**

315,638,414

**Deferred Credits and Other Liabilities**

Deferred Income Taxes	161,150,408
Investment Tax Credit	4,779,803
Asset Retirement Obligations	6,483,335
Other	69,533,114
<b>Total Deferred Credits and Other Liabilities</b>	<b>241,946,660</b>

**Total Liabilities**

**693,036,719**

**Total Equity**

Common Stock- \$15.00 par value, 1,000,000 shares authorized and 585,333 shares outstanding	8,779,995
Additional Paid in Capital	167,494,135
Retained Earnings	236,940,139
<b>Total Equity Including Minority Interest</b>	<b>413,214,269</b>

**Total Liabilities and Equity**

**1,106,250,988**