COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

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| APPLICATION OF DUKE ENERGY KENTUCKY, INC. FOR DEVIATION FROM AFFILIATE PRICING REQUIREMENTS AND APPROVAL OF AN INTERCOMPANY ASSET TRANSFER AGREEMENT | ) ) ) ) ) ) | CASE NO. 2008-00122 |

O R D E R

Duke Energy Kentucky, Inc. ("Duke Kentucky") has applied for Commission approval to deviate from the affiliate pricing requirements set forth in KRS 278.2207(1)(a) and (b) and to engage in transactions with its affiliates, Duke Energy Carolinas, Duke Energy Ohio, and Duke Energy Indiana ("Duke Affiliates"), pursuant to the terms of a proposed Intercompany Asset Transfer Agreement ("Agreement").

DISCUSSION

Duke Kentucky is a Kentucky corporation engaged in the business of selling and distributing natural gas and transmitting and distributing electricity within the Commonwealth of Kentucky and is regulated by the Commission as a utility under KRS 278.010(3).

Duke Kentucky proposes to enter into an Agreement that provides for the transfer of assets, other than commodities, by and between it and the Duke Affiliates at the transferring party's cost or through in-kind replacements, provided such transfer will not jeopardize the transferring party's ability to provide utility service.[1] While Duke Kentucky recognizes that, as a jurisdictional utility, all transactions with its affiliates must be in accordance with the affiliate transaction rules set forth in KRS 278.2201 through 278.2213, it admits that the Agreement's pricing arrangement is not in accordance with those rules. It contends, however, that the Agreement is reasonable and in the public interest and requests that the Commission, pursuant to its authority under KRS 278.2207(2),[2] grant approval to deviate from the pricing rules and to enter into the Agreement.

In support of its request, Duke Kentucky states that one of the benefits of being part of a large public utility holding company is the ability to leverage the relationship among the affiliated utility companies to realize operational efficiencies. It asserts that the proposed Agreement will enable Duke Kentucky and its affiliates to realize such efficiencies by allowing each company access to a wider supply of equipment and inventory and allowing it to secure assets without potential costly delays. Duke Kentucky contends, however, that the affiliate pricing rules set forth in

[1] There is an exception that the Federal Energy Regulatory Commission ("FERC") requires all transfers of generation equipment between Duke Energy Ohio and the regulated utilities, including Duke Kentucky, to be in compliance with FERC-approved affiliate transfer pricing rules and orders.

[2] KRS 278.2207(2) provides:

> A utility may file an application with the commission requesting a deviation from the requirements of this section for a particular transaction or class of transactions. The utility shall have the burden of demonstrating that the requested pricing is reasonable. The commission may grant the deviation if it determines the pricing is in the public interest.

KRS 278.2207(1)(a) and (b),[3] which require an affiliate to charge the lesser of cost or market when transferring equipment to it, but pay the greater of cost or market when receiving equipment from it, discourage its affiliates from transacting business with Duke Kentucky.

Duke Kentucky further states that the Agreement is reasonable since, pursuant to its terms, the Kentucky Public Service Commission will continue to retain authority under KRS 278.218 over all transactions involving electric utility assets that have an original book value of one million dollars and are to be transferred for reasons other than obsolescence or are to be used to provide the same or similar service to the utility's customers. In responses to data requests, Duke Kentucky agreed that it would also seek Commission authority over all transactions involving its gas utility assets under the same terms and conditions as in KRS 278.218.[4] In addition, Duke Kentucky states that it will maintain a list of all Agreement transactions in its Cost Allocation Manual and comply with all statutory requirements regarding accounting and cross-subsidization.

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[3] KRS 278.2207(1)(a) and (b) provide:

> (1) The terms for transactions between a utility and its affiliates shall be in accordance with the following:
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> (a) Services and products provided to an affiliate by the utility pursuant to a tariff shall be at the tariffed rate, with nontariffed items priced at the utility's fully distributed cost but in no event less than market, or in compliance with the utility's existing USDA, SEC, or FERC approved cost allocation methodology.
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> (b) Services and products provided to the utility by an affiliate shall be priced at the affiliate's fully distributed cost but in no event greater than market or in compliance with the utility's existing USDA, SEC, or FERC approved cost allocation methodology.

[4] See Response to the Commission Staff's First Data Request, Item 2.

The Commission, having considered the record and being otherwise sufficiently advised, finds that the proposed Agreement, along with Duke Kentucky's additional commitment to be bound by the same terms of KRS 278.218 for all transactions involving gas assets, is reasonable and should be beneficial to Duke Kentucky and its customers. Therefore, the Commission finds that Duke Kentucky's request to deviate from the provisions of KRS 278.2207(1)(a) and (b) is in the public interest and should be granted for the transactions presented in this proceeding.

IT IS THEREFORE ORDERED that:

1. Duke Kentucky's request for approval to deviate from KRS 278.2207(1)(a) and (b) to allow it to enter into the Agreement proposed in this proceeding is granted, subject to its agreement that the same terms and conditions applicable to electric utility transactions as set forth in KRS 278.218 shall also apply to transactions involving its gas assets.

2. Duke Kentucky shall maintain a list of all Agreement transactions in its Cost Allocation Manual and comply with all statutory requirements regarding accounting and cross-subsidization.

Done at Frankfort, Kentucky, this 18th day of July, 2008.

By the Commission

ATTEST:

Stephanie Stumbo

Executive Director