DUKE ENERGY CORPORATION

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VIA OVERNIGHT DELIVERY

March 12, 2013

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

Re: In the Matter of the Joint Application of Duke Energy Corporation, Duke Energy Holding Corp., Deer Acquisition Corp., Cougar Acquisition Corp., Cinergy Corp., The Cincinnati Gas & Electric Company and The Union Light, Heat and Power Company for Approval of a Transfer and Acquisition of Control,
Case No. 2005-00228

Dear Mr. Derouen:

In the Settlement Agreement in the above-referenced case, Duke Energy Kentucky, Inc. (Duke Energy Kentucky) made several merger commitments. Attached herein is an original and ten copies of the Final Report Affiliate Management Audit of Duke Energy Kentucky in response to Merger Commitment No. 12.

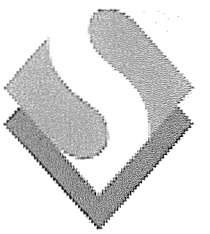
Please file stamp the two copies of this letter and the Final Report enclosed herein and return in the enclosed return-addressed envelope.

Sincerely,

Kristen Cocanougher

cc: Dennis Howard II (w/o enclosures)

Schumaker & Company



2011 Affiliate Management Audit
of
Duke Energy Kentucky

Case Number: 2005-00228
Final Report

January 31, 2013

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of
Duke Energy Kentucky

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January 31, 2013

I. Executive Summary

A. Background & Perspective

In 2006, Cinergy Corp. (Cinergy), the parent company of Union Light, Heat and Power Company (ULH&P), subsequently re-named Duke Energy Kentucky (DEK), merged with Duke Energy Corporation (Duke Energy). As part of its approval of the merger, the Kentucky Public Service Commission (KPSC) established forty-six merger commitments in Case No. 2005-00228, of which three (3), specifically Commitments 11, 12, and 13 specifically relate directly to this audit. They apply as follows:

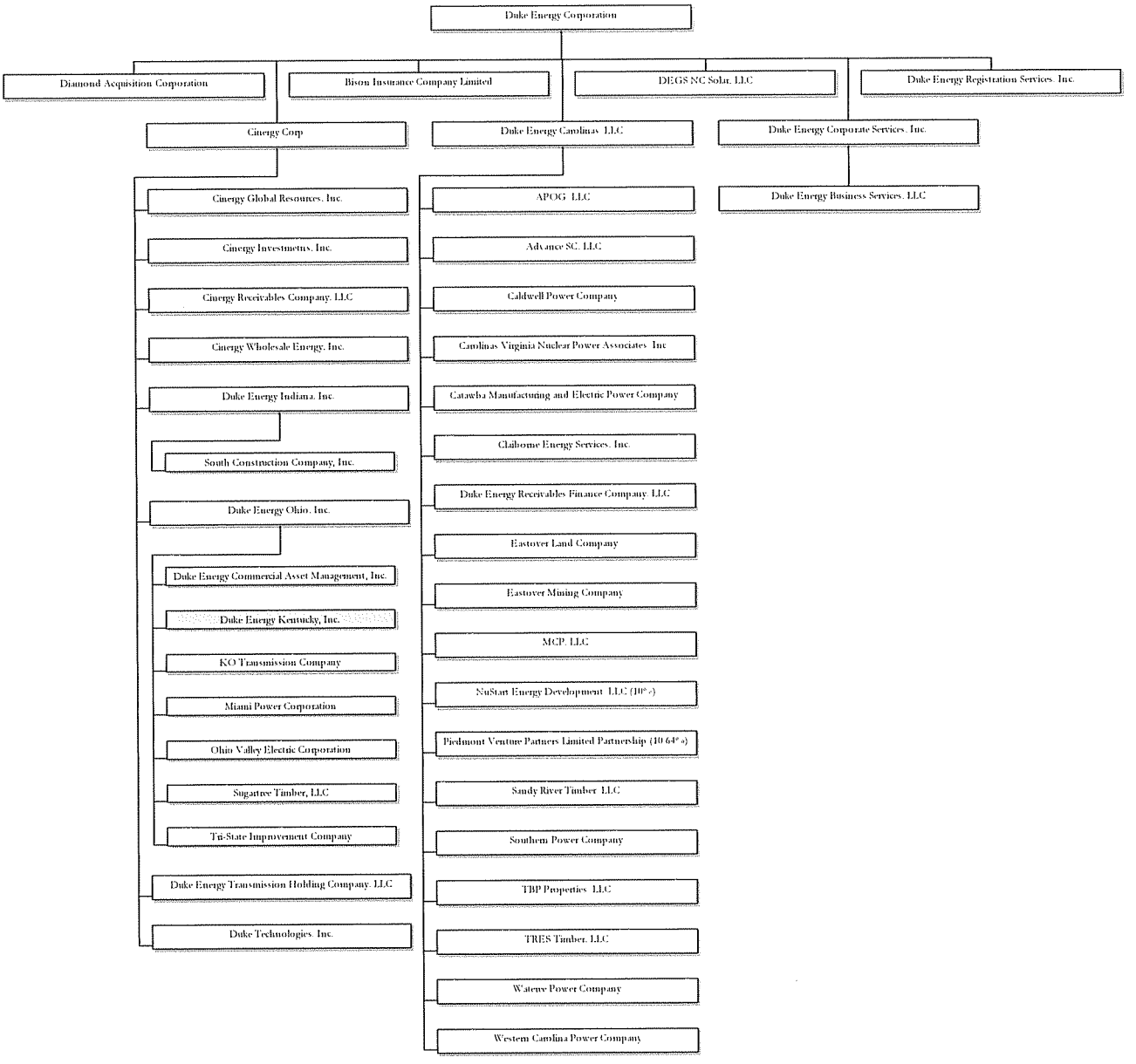
- DEK is in compliance with its Commitment 11, which requires proper accounting of costs.
- DEK is in compliance with its Commitment 12, which requires that it maintain appropriate cost allocation procedures and commit to third-party audits.
- DEK is in compliance with its Commitment 13, which requires that it protect against cross-subsidization.

Also within the scope of this audit is DEK's compliance with KPSC regulations, including:

- 807 KAR 5:080 SECTION 2 — Annual reports
- 807 KAR 5:080 SECTION 3 — Filing of cost allocation manual and amendments
- 807 KAR 5:080 SECTION 4 — Notice of establishment of new non-regulated activity

Duke Energy Kentucky is part of the Duke Energy Corporation organization, in which its summary organization structure, as of December 31, 2011 is depicted on *Exhibit I-1*.[1]

Exhibit I-1
Summary Duke Energy Corporation Organization
as of December 31, 2011



Source: Information Response Attachment C.

B. Objectives, Scope, and Methodology

Audit Methodology

Schumaker & Company followed a three-step process designed to sustain vital, interactive working relationships our project team and DEK. Our approach for achieving the audit objectives was as follows:

- Step I – Diagnostic Review
- Step II – Detailed Review and Analysis
- Step III – Draft and Final Report Preparation

Work Plan

Each task area in our work plan was designed to allow our team to efficiently gather and analyze information necessary to develop an opinion whether DEK adequately complied with Kentucky's affiliate standards in 2011. The tables on the following pages illustrate a general discussion of the type of work steps typically performed for each task area, as well as the preliminary information that would be required and the key indicators that we would use to assess that specific task area.

Affiliate Relationships		
Typical Work Steps	**Information Required**	**Key Indicators**
Review governing regulations, orders, and decisions from the Commission regarding affiliate transactions and determine if these affiliate relations rules have been fully complied with by DEK; identify any situations of non-compliance and determine the actual or potential impact of this non-compliance. Obtain DEK organization charts showing the relationships of DEK with its affiliates. Identify all affiliates that had transactions with DEK during the last three years. Identify all products and services provided from/to regulated and unregulated affiliates of DEK during the last three years. Document the frequency and dollar magnitude of all affiliate goods and services by year and by affiliate for all items received by or provided by DEK. Develop diagrams, graphs, and/or tabulations identifying affiliates, services, dollar magnitude, and other useful information and data. Explain any significant trends or changes. Analyze trends of these allocated amounts compared to the trends of these costs in the parent/affiliate. Separately identify affiliate transactions involving the transfer of employees, property, and/or technology. Identify, by plant category, any capital expenditures made by affiliates but allocated to DEK's operations. Evaluate any transactions that have had a significant effect on depreciation expense. Identify shared facilities, systems, and programs among affiliates including employee training, joint purchasing, information technology, advertising and promotion, and corporate support services. Review internal systems for providing assurance that goals and objectives are accomplished at the lowest possible cost and maximum benefit to ratepayers. Identify internal controls in place to protect against irregular, illegal, and/or improper transactions. Review filings, reports, and communications involving affiliate relationships.	Copies of all governing regulations, orders, and decisions from the Commission regarding affiliate transactions Duke Energy and DEK organization charts showing all affiliate relationships, including regulatory status of affiliates Description of all products and services provided from/to regulated and unregulated affiliates of DEK during the last three years Level and nature of affiliated transactions (actual and budget dollars) from/to DEK's operations and affiliates during the last three years, including a breakdown by: ◆ From/to affiliate ◆ Type of transaction ◆ Time period Actual dollars and personnel equivalents, by functional category, for each associated regulated and/or non-regulated DEK affiliate The level and nature of affiliated transactions (actual and budgeted capital expenditure dollars, by plant category) allocated to DEK's operations by affiliates during the last three years – as compared to its parent/affiliates Any cost allocation manual documentation, including formulas and basis	All affiliate transactions of DEK should be in complete compliance with all of the governing regulations, orders, and decisions from the Commission regarding affiliate transactions. The relationships with affiliates are clearly documented. The costs are fairly representative of the value of goods and services provided and of the benefits derived by Kentucky ratepayers. DEK should be able to easily furnish information regarding the products and services provided to/from its affiliates and the corresponding financial transactions that result. DEK should not be negatively impacted by its relationships in the overall corporate organization. Any affiliate costs charged to DEK are reasonable and competitive in the market.

Cost Allocation Methodologies – Affiliate Transactions and Cost Accumulation and Assignment		
Typical Work Steps	**Information Required**	**Key Indicators**
Determine procedures specified for identifying, tracking, and posting direct, indirect, and general overhead costs to specific projects or cost pools. Determine how these assignment policies, procedures, and practices have changed over time; assess the rationale for these changes. Assess methodologies (e.g., accounting systems) used to accumulate and assign costs. Examine criteria used to assign costs. Evaluate Duke Energy's hierarchy for placing emphasis on direct billing versus cost allocation, and for developing causal relationships in formulating allocation methodologies. Evaluate whether direct billing is used whenever possible. Assess whether cost accumulation/assignment bases are reasonable and appropriate (e.g., based on cost causative factors) and whether they have been consistently developed. Review documentation involving policies and guidelines in place to establish the appropriation of resources and costs, including (but not limited to): ◆ Finance manuals ◆ Assignment policies ◆ Cost allocation manuals Identify generic direct billing and/or cost allocation methodologies in place within DEK and its affiliates used to calculate the costs for services or products provided. Assess whether cost allocation methodologies, and their associated bases and factors, are reasonable and appropriate, and whether they have been consistently applied. Assess whether these methodologies are regularly reviewed and revised. Determine whether the policies, procedures, and practices governing these transfer pricing methodologies and accounting standards are adequately documented and understood by the personnel involved. Identify the data sources and special studies required to develop allocations factors (if they are used), and evaluate their appropriateness. Determine how allocation policies, procedures, and practices have changed over time; assess the rationale for these changes.	Any cost accounting documentation involving cost accumulation and assignment Copies of DEK's general ledger and pertinent subsidiary ledgers Any accounting manuals and other documentation describing methodologies, bases, and factors used for direct billing and/or cost allocation, and/or segregating regulated and unregulated costs, including (but not limited to): ◆ Finance manuals ◆ Assignment policies ◆ Cost allocation manuals Description of daily accounting standards and recordkeeping methods and procedures that support the daily operations between DEK and its affiliates	DEK and its affiliates should have in place well-defined and consistently applied procedures for accumulating and assigning costs, and should be able to provide timely, current, and accurate information regarding the level, nature, and magnitude of costs incurred. Direct billing and allocation methodologies used by DEK and its affiliates should be founded on reasonable and fair factors and bases that properly reflect the value of products and services received, and should be supported by automated systems and contracts that provide management with the information and data it needs for recording and managing these activities. DEK should not be negatively impacted by its relationships in the overall corporate organization. Any affiliate costs charged to DEK are reasonable and competitive in the market.

Cost Allocation Methodologies – Affiliate Transactions and Cost Accumulation and Assignment		
Typical Work Steps	**Information Required**	**Key Indicators**
Determine if contracts are in place and current where appropriate. Determine if the formal contracts define the nature of affiliate services rendered, set forth clearly defined bases for associated charges, and stipulate terms and conditions favorable to DEK's regulated operations in the Kentucky. Determine if any contracts with third parties involving more than one affiliate provide DEK's operations with full consideration for performance, taking into account risk premiums or time value of money implicit in the payment or collection terms of such contracts. Assess whether the direct billing and cost allocation processes are adequately automated. Evaluate those mechanisms and procedures in the direct charges/cost allocation guidelines intended to guard against the cross-subsidization of unregulated entities, either through intentional or unintentional means. Identify the extent to which DEK's financial strength is impacted by or insulated from its affiliated (regulated or unregulated) companies.		
Identify the decision-making process used in the determination of services required, and for identifying the most optimum means of providing these services. Identify how DEK determines whether internal or external resources are used; identify instances of comparisons between outside vendors and internal resources for products and services provided to DEK.	Any analyses regarding use of external vendors for the development and delivery of services to DEK and its operations Any cost/benefit analyses performed during the last three years regarding provision of services by DEK or its affiliates	Decisions pertaining to the use of external vendors should be based on analysis that considers cost-benefit, financial, and other factors. These decisions should consider comparisons to provision directly by DEK or its affiliates, as well as the benefits that customers of regulated operations will receive.

II. Affiliate Relationships

A. Background & Perspective

Organization Structure

While *Exhibit I-1* displayed in the *Executive Summary* chapter is a summary look at Duke Energy Corporation's (Duke Energy's) organization, *Exhibit II-2* is a detailed look, after subsequent changes were made in the first quarter of 2012.[2]

Exhibit II-2
Detailed Duke Energy Corporation Organization Structure
as of March 31, 2012
(Page 1 of 7)

Summary Level

- Duke Energy Corporation (DE 5 3 2005)
  - Diamond Acquisition Corporation (100%)(NC, 1 26 2011)
  - Duke Energy Registration Services Inc (100%)(DE 11 18 1998)
  - Bison Insurance Company Limited (100%)(Bermuda 12 11 1968)
    - NorthSouth Insurance Company Limited (100%)(Bermuda 12 2 2002)
  - Cinergy Corp (100%)(DE 6 30 1993)
  - DEGS NC Solar, LLC (100%)(DE 02 25 2010)
    - CS Murphy Point, LLC (100%)(NC 1 12 2010)
    - Martins Creek Solar NC, LLC (100%)(NC, 4 8 2010)
    - Murphy Farm Power, LLC (100%)(NC 01 27 2010)
    - North Carolina Renewable Properties, LLC (100%)(NC 6 3 2010)
    - Solar Star North Carolina I, LLC (100%)(DE 11 07 2008)
    - Solar Star North Carolina II, LLC (100%)(DE 12 16 2009)
    - Taylorsville Solar, LLC (100%)(DE 4 29 2010)
  - Duke Energy Carolinas, LLC (100%)(NC 11 27 1963)
    - APOG, LLC (20%)(DE 6 22 2007)
    - Advance SC LLC (100%)(SC 7 9 2004)
    - Caldwell Power Company (100%)(NC 7 28 1921)
    - *Carolinas Virginia Nuclear Power Associates, Inc* (25%)(NC 10 4 1956)
    - Catawba Manufacturing and Electric Power Company (100%)(NC 10 15 1901)
    - Claiborne Energy Services, Inc (100%)(LA 3 1 1990)
    - Duke Energy Receivables Finance Company, LLC (100%)(DE 7 16 2003)
    - Eastover Land Company (100%)(KY 6 30 1970)
    - Eastover Mining Company (100%)(KY 7 15 1970)
    - Greenville Gas and Electric Light and Power Company (100%)(SC 1 28 1861)
    - MCP, LLC (100%)(SC 8 18 2000)
    - NuStart Energy Development, LLC (10%)(DE 4 19 2004)
    - *Piedmont Venture Partners Limited Partnership (10 64%)(NC 10 3 1996)*
    - Sandy River Timber, LLC (100%)(SC, 10 26 2007)
    - Southern Power Company (100%)(NC 12 30 1927)
    - TBP Properties, LLC (100%)(SC 12 11 2006)
    - TRES Timber, LLC (100%)(SC 12 11 2006)
    - Wateree Power Company (100%)(SC)
    - Western Carolina Power Company (100%)(NC 9 10 1907)
  - Duke Energy Corporate Services, Inc (100%)(DE 06 26 2008)
    - Duke Energy Business Services LLC (100%)(DE 11 18 1998)

Source: Information Response 1

Exhibit II-3
Detailed Duke Energy Organization Structure
as of March 31, 2012
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Duke Energy Registration Services

Duke Energy Corporation
- Duke Energy Registration Services, Inc. (100%)

Duke Energy Registration Services, Inc (100%)(DE 11.18.1998)
- PanEnergy Corp (100%)(DE 1.26.1981)
  - Duke Energy Services, Inc (100%)(DE 6.8.1959)
    - Duke Energy Marketing Corp (100%)(NV 11.7.1994)
      - Duke/Louis Dreyfus L.L.C. (50%)(NV 3.1.1995)
    - DETMI Management, Inc. (100%)(CO 6.21.1994)
      - DTMSI Management Ltd (100%)(British Columbia 12.18.2009)
        - Duke Energy Services Canada ULC (31%)(British Columbia 09.17.2009)
        - DE Marketing Canada Ltd (60%)(British Columbia 12.18.2009)
          - Duke Energy Marketing Limited Partnership (1%)(Alberta 8.1.1996)
      - Duke Energy Trading and Marketing, L.L.C. (60%)(DE 7.10.1996)
      - Duke Ventures, LLC (100%)(NV 12.19.2000)
        - Duke Ventures Real Estate, LLC (100%)(DE 6.09.2009)
    - Dixilyn-Field Drilling Company (100%)(DE 1.31.1977)
      - Dixilyn-Field (Nigeria) Limited (100%)(Nigeria 11.14.1977)
      - Dixilyn-Field International Drilling Company, S.A. (100%)(Panama 6.10.1970)
    - Duke Energy Services Canada ULC (69%)(British Columbia 09.17.2009)
      - Duke Energy Marketing Limited Partnership (59.40%)(Alberta Canada 8.1.1996)
    - DukeNet VentureCo, Inc (100%)(DE 05.18.2010)
      - DukeNet Communications Holdings, LLC (50%)(DE 05.18.2010)
        - DukeNet Communications, LLC (100%)(DE 05.18.2010)
          - DukeNet/TCG LLC (21.6%)(NC 12.12.1997)
  - Eastman Whipstock do Brasil Ltda (100%)(Brazil, 5.21.1979)
  - Eastman Whipstock S.A. (100%)(Argentina 10.13.1981)
  - Energy Pipelines International Company (100%)(DE 4.28.1975)
  - Duke Energy China Corp (100%)(DE 8.13.1976)
  - Seahorse do Brasil Servicos Maritimos Ltda. (100%)(Brazil 3.30.1979)
- Duke Energy Americas, LLC (100%)(DE 7.2.2004)
  - Duke Energy International, LLC(DE 9.18.1997)
  - Duke Energy Merchants, LLC (100%)(DE 4.23.1999)
  - Duke Energy North America, LLC (100%)(DE 9.18.1997)
    - Duke Energy Marketing America, LLC (100%)(DE 1.3.2001)
    - Duke Energy Moapa, LLC (100%)(DE 4.11.2000)
- Duke Energy Carolinas Plant Operations, LLC (100%)(DE 5.29.2001)
  - DE Nuclear Engineering, Inc. (100%)(NC 3.17.1969)
- Duke Energy Royal, LLC (100%)(DE 3.13.2002)
- Duke/Louis Dreyfus L.L.C. (50%)(NV 3.1.1995)
- Duke Project Services, Inc. (100%)(NC 7.1.1966)
  - D/FD Operating Services LLC (50.0001%)(DE 3.7.1996)
  - Duke/Fluor Daniel (50.0001%)(NC 9.1.1997)
    - D/FD Holdings, LLC (100%)(DE 12.15.2005)
  - Duke/Fluor Daniel El Salvador S.A. de C.V. (50%)(El Salvador)
  - Duke/Fluor Daniel International (50.0001%)(NV 9.1.1994)
    - Duke/Fluor Daniel Caribbean, S.E. (99%)(Puerto Rico 12.6.1996)
  - Duke/Fluor Daniel International Services (50.0001%)(NV 9.1.1994)
    - Duke/Fluor Daniel Caribbean, S.E. (0.50%)(Puerto Rico 12.6.1996)
    - Duke/Fluor Daniel International Services (Trinidad) Ltd (100%)(Trinidad and Tobago 12.3.1998)
- Duke Energy Murray Operating, LLC (100%)(DE 8.7.2001)

Exhibit II-4
Detailed Duke Energy Organization Structure
as of March 31, 2012
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Cinergy Corporation
(including Duke Energy Kentucky organization)

Duke Energy Corporation
- Cinergy Corp. (100%)

Cinergy Corp. (100%)(DE 6.30.1993)
- Cinergy Global Resources, Inc. (100%)(DE 5.15.1998)
- Cinergy Investments, Inc. (100%)(DE 10.24.1994)
  - Duke Energy Commercial Enterprises, Inc. (100%)(IN 10.8.1992)
  - Cinergy-Centrus, Inc. (100%)(DE 4.23.1998)
  - Cinergy-Centrus Communications, Inc. (100%)(DE 7.17.1998)
  - Cinergy Technology, Inc. (100%)(IN 12.12.1991)
  - Duke-Cadence, Inc. (100%)(IN 12.27.1989)
  - Duke Communications Holdings, Inc. (100%)(DE 9.20.1996)
    - Conterra Ultra Broadband Holdings, Inc. (11%)(DE 12.31.2009)
  - Duke Energy Engineering, Inc. (100%)(OH 3.28.1997)
  - Duke Energy Generation Services Holding Company, Inc. (100%)(DE 2.11.1997)
  - Duke-Reliant Resources, Inc. (100%)(1.14.1998)
- Cinergy Receivables Company, LLC (100%)(DE 1.10.2002)
- Cinergy Wholesale Energy, Inc. (100%)(OH 11.27.2000)
  - Cinergy Power Generation Services, LLC (100%)(DE 11.22.2000)
- Duke Energy Indiana, Inc. (100%)(IN 9.6.1941)
  - South Construction Company, Inc. (100%)(IN 5.31.1934)
- Duke Energy Ohio, Inc. (100%)(OH 4,3,1837)
  - Duke Energy Commercial Asset Management, Inc. (100%)(OH 12.5.2000)
    - Duke Energy Fayette II, LLC (100%)(DE 10.14.2010)
    - Duke Energy Hanging Rock II, LLC (100%)(DE 10.14.2010)
    - Duke Energy Lee II, LLC (100%)(DE 10.14.2010)
    - Duke Energy Vermillion II, LLC (100%)(DE 10.14.2010)
    - Duke Energy Washington II, LLC (100%)(DE 10.14.2010)
  - Duke Energy Kentucky, Inc. (100%)(KY 3.20.1901)
  - KO Transmission Company (100%)(KY 4.11.1994)
  - Miami Power Corporation (100%)(IN 3.25.1930)
  - Ohio Valley Electric Corporation (9%)
  - Sugartree Timber, LLC (100%)(DE 7.24.2008)
  - Tri-State Improvement Company (100%)(OH 1.14.1964)
- Duke Energy Transmission Holding Company, LLC (100%)(DE 7.16.2008)
  - Duke-American Transmission Company, LLC (50%)(DE 4.11.2011)
  - Pioneer Transmission, LLC (50%)(IN 7.31.2008)
- Duke Technologies, Inc. (100%)(DE 7.26.2000)
  - Duke Energy One, Inc. (100%)(DE 9.5.2000)
    - Cinergy Solutions – Utility, Inc. (100%)(DE 9.27.2004)
  - Duke Investments, LLC (100%)(DE 7.25.2000)
    - Current Group, LLC (0.395%)(DE 10.24.2000)
  - Duke Supply Network, LLC (100%)(DE 8.10.2000)
  - Duke Ventures II, LLC (100%)(DE 9.1.2000)

Exhibit II-5
Detailed Duke Energy Organization Structure
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Cinergy Global Resources, Inc.

Duke Energy Corporation
- Cinergy Corp. (100%)
  - Cinergy Global Resources, Inc. (100%)

Cinergy Global Resources, Inc. (100%)(DE 5.15.1998)
- Cinergy Global Power, Inc. (100%)(DE 9.4.1997)
  - CGP Global Greece Holdings, SA (99.99%)(Greece 8.10.2001)
  - Cinergy Global (Cayman) Holdings, Inc. (100%)(Cayman Islands 9.4.1997)
    - Cinergy Global Tsavo Power (100%)(Cayman Islands 9.4.1997)
      - IPS-Cinergy Power Limited (48.2%)(Kenya 4.28.1999)
        - Tsavo Power Company Limited (49.9%)(Kenya 1.22.1998)
  - Cinergy Global Holdings, Inc. (100%)(DE 12.18.1998)
    - CGP Global Greece Holdings, SA (.01%)(Greece 8.10.2001)
  - Cinergy Global Power Africa (Proprietary) Limited (100%)(South Africa 8.3.1999)

Duke Energy Commercial Enterprises, Inc.

Duke Energy Corporation
- Cinergy Corp. (100%)
  - Cinergy Investments, Inc. (100%)
    - Duke Energy Commercial Enterprises, Inc. (100%)

Duke Energy Commercial Enterprises, Inc. (100%)(IN 10.8.1992)
- Brownsville Power I, L.L.C. (100%)(DE 7.13.1998)
- CinCap V, LLC (10%)(DE 7.21.1998)
- Cinergy Climate Change Investments, LLC (100%)(DE 6.9.2003)
- Cinergy General Holdings, LLC (100%)(DE 12.14.2001)
- Cinergy Limited Holdings, LLC (100%)(DE 12.14.2001)
- Cinergy Retail Power General, Inc. (100%)(TX 8.7.2001)
- Duke Energy Retail Sales, LLC (100%)(DE 12.9.2003)
- Ohio River Valley Propane, LLC (100%)(DE 10.18.2001)
- SynCap II, LLC (100%)(DE 10.13.2000)

Exhibit II-6
Detailed Duke Energy Organization Structure
as of March 31, 2012
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Duke Energy Generation Services Holding Company, Inc.

Duke Energy Corporation
- Cinergy Corp. (100%)
  - Cinergy Investments, Inc. (100%)
    - Duke Energy Generation Services Holding Company, Inc. (100%)

Duke Energy Generation Services Holding Company, Inc. (100%)(DE 2.11.1997)
- DEGS Biomass, LLC (100%)(DE 9.22.2008)
  - ADAGE LLC (50%)(DE 9.9.2008)
- DEGS of Boca Raton, LLC (100%)(DE 9.4.1998)
- DEGS of Cincinnati, LLC (100%)(OH 7.29.1997)
- DEGS Solar, LLC (100%)(DE 05.13.2010)
  - INDU Solar Holdings, LLC (50%)(DE 10.14.2010)
    - ISH Solar AZ, LLC (100%)(DE 12.9.2011)
    - ISH Solar Beach, LLC (100%)(DE 11.18.2011)
    - ISH Solar CA, LLC (100%)(DE 12.9.2011)
    - ISH Solar Central, LLC (100%)(DE 10.10.2011)
    - ISH Solar Grin, LLC (100%)(DE 8.16.2011)
    - ISH Solar Hospitals, LLC (100%)(DE 12.8.2009)
    - ISH Solar Mouth, LLC (100%)(DE 12.9.2011)
    - SEC BESD Solar One, LLC (100%)(DE 12.07.2009)
    - SEC Bellefonte SD Solar One, LLC (100%)(DE 03.04.2010)
  - Panoche Valley Solar LLC (25%)(DE 3.13.2012)
  - RE AZ Holdings LLC (100%)(DE 10.11.2010)
    - RE Ajo 1 LLC (100%)(DE 10.5.2009)
    - RE Bagdad Solar 1 LLC (100%)(DE 8.13.2009)
  - RP-Orlando, LLC (100%)(DE 3.5.2010)
  - TX Solar I LLC (100%)(DE 05.27.2009)
- DEGS of St. Paul, LLC (100%)(DE 8.13.1998)
  - Environmental Wood Supply, LLC (50%)(MN 8.10.2000)
  - St. Paul Cogeneration, LLC (50%)(MN 12.18.1998)
- DEGS of Tuscola, Inc. (100%)(DE 10.13.1998)
- DEGS Wind I, LLC (100%)(DE 5.23.2007)

- Delta Township Utilities, LLC (51%)(DE 7.5.2001)
- Delta Township Utilities II, LLC (46%)(DE 3.25.2004)
- Duke Energy Generation Services, Inc (DE 6.2.2000)

- Energy Equipment Leasing LLC (49%)(DE 11.12.1998)
- Owings Mills Energy Equipment Leasing, LLC (49%)(DE 10.20.1999)
- SUEZ-DEGS, LLC (50%)(DE 2.18.1997)
- SUEZ-DEGS of Ashtabula, LLC (49%)(DE 4.21.1999)
- SUEZ-DEGS of Lansing, LLC (51%)(DE 11.3.1999)
  - SUEZ/VWNA/DEGS of Lansing, LLC (80%)(DE 11.3.1999)
- SUEZ-DEGS of Orlando, LLC (100%)(DE 6.12.1998)
- SUEZ-DEGS of Owings Mills, LLC (49%)(DE 9.20.1999)
- SUEZ-DEGS of Rochester, LLC (49%)(DE 10.20.1999)
- SUEZ-DEGS of Silver Grove, LLC (49%)(DE 3.18.1999)
- SUEZ-DEGS of Tuscola, LLC (49%)(DE 8.21.1998)

Exhibit II-7
Detailed Duke Energy Organization Structure
as of March 31, 2012
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DEGS Wind I, LLC

Duke Energy Corporation
- Cinergy Corp (100%)
  - Cinergy Investments, Inc (100%)
    - Duke Energy Generation Services Holding Company, Inc (100%)
      - DEGS Wind I, LLC (100%)

DEGS Wind I, LLC (100%)(DE 5.23.2007)
- Ball Hill Windpark, LLC (100%)(DE, 9.29.06)
- Catamount Energy Corporation (100%)(VT 6.23.1992)
- DEGS Wind Supply, LLC (100%)(DE, 12.11.2007)
- DEGS Wind Supply II, LLC (100%)(DE 8.26.2008)
- Green Frontier Windpower Holdings, LLC (100%)(DE 02.22.2010)
  - Green Frontier Windpower, LLC (100%)(DE 05.13.2010)
    - Three Buttes Windpower, LLC (100%)(DE 8.26.2008)
    - Silver Sage Windpower, LLC (100%)(DE 4.16.2007)
    - Happy Jack Windpower, LLC (100%)(DE 10.27.2006)
    - Kit Carson Windpower, LLC (100%)(DE 6.23.09)
    - North Allegheny Wind, LLC (100%)(DE 5.31.06)
- Ironwood-Cimarron Windpower Holdings, LLC (100%)(DE 12.8.2010)
  - Free State Windpower, LLC (100%)(DE 2.1.2012)
    - Ironwood Windpower, LLC (100%)(DE 12.8.2010)
    - Cimarron Windpower II, LLC (100%)(DE 3.7.2011)
- Los Vientos Windpower I Holdings, LLC (100%)(DE, 1.27.2011)
  - Los Vientos Windpower IA, LLC (100%)(DE, 1.27.2011)
  - Los Vientos Windpower 1B, LLC (100%)(DE 7.11.2011)
- Notrees Windpower, LP (99%)(DE 9.30.2005)
- Ocotillo Windpower, LP (99%)(DE 12.22.2004)
- Shirley Wind, LLC (100%)(WI 10.20.2006)
- TE Notrees, LLC (100%)(DE 9.30.2005)
  - Notrees Windpower, LP (1%)(DE 9.30.2005)
- TE Ocotillo, LLC (100%)(DE 12.21.2004)
  - Ocotillo Windpower, LP (1%)(DE 12.22.2004)
- Catamount Energy Corporation (100%)(VT 6.23.1992) [DEGS Wind Vermont, Inc. (VT, 06.20.2008)]
  - Equinox Vermont Corporation (100%)(VT 5.1.1990)
    - Catamount Rumford Corporation (100%)(VT 4.11.1989)
    - Ryegate Associates (33.1126%)(UT 4.30.1990)
  - Catamount Sweetwater Corporation (100%)(VT 6.17.2003)
    - Sweetwater Development LLC (100%)(TX 11.5.2002)
    - Sweetwater Wind 6 LLC (100%)(DE 4.29.2004)
    - Sweetwater Wind Power L.L.C. (100%)(TX 11.5.2002)
  - Catamount Sweetwater Holdings LLC (100%)(VT 6.20.2005)
    - Catamount Sweetwater 1 LLC (100%)(VT 12.12.2003)
      - Sweetwater Wind 1 LLC (13.59%)(DE 6.24.2003)
    - Catamount Sweetwater 2 LLC (100%)(VT 5.5.2004)
      - Sweetwater Wind 2 LLC (13.14%)(DE 4.19.2004)
    - Catamount Sweetwater 3 LLC (100%)(VT 6.3.2004)
      - Sweetwater Wind 3 LLC (13.18%)(DE 4.29.2004)
  - Catamount Sweetwater 4-5 LLC (100%)(VT 3.8.2005)
    - Sweetwater 4-5 Holdings LLC (18.72%)(DE 4.18.2007)
      - Sweetwater Wind 4 LLC (100%)(DE 4.29.2004)
      - Sweetwater Wind 5 LLC (100%)(DE 4.29.2004)
  - Laurel Hill Wind Energy, LLC (100%)(PA 12.14.2004)
  - CEC Wind Development LLC (100%)(VT 1.12.2007)
  - Searchlight Wind Energy LLC (100%)(NV 1.17.2008)
  - Willow Creek Wind Energy LLC (100%)(DE 6.18.2007)
  - Top of the World Wind Energy Holdings LLC (100%)(DE 11.15.2010)
    - Top of the World Wind Energy LLC (100%)(DE 3.13.2008)
  - Catamount Sweetwater 6 LLC (100%)(VT 9.7.2005)
  - CEC UK1 Holding Corp (100%)(VT 9.11.2002)
    - Catamount Energy SC 1 (1%)(Scotland 10.8.2002)
      - Catamount Energy SC 2 (99%)(Scotland 10.8.2002)
    - Catamount Energy SC 2 (1%)(Scotland 10.8.2002)
      - Catamount Energy SC 3 (99%)(Scotland 10.8.2002)
    - Catamount Energy SC 3 (1%)(Scotland 10.8.2002)
      - Andershaw Wind Power Limited (50%)(England and Wales, 12.19.2011)
      - Barmoor Wind Power Limited (50%)(England and Wales, 9.10.2010)
      - Catamount Celtic Energy Limited (100%)(Scotland 6.8.2007)
      - Catamount Energy Limited (50%)(UK 8.15.2002)
  - CEC UK2 Holding Corp. (100%)(VT 9.11.2002)
    - Catamount Energy SC 1 (99%)(Scotland 10.8.2002)

Exhibit II-8
Detailed Duke Energy Organization Structure
as of March 31, 2012
(Page 7 of 7)

Duke Energy Generation Services, Inc.

Duke Energy Corporation
- Cinergy Corp (100%)
  - Cinergy Investments, Inc (100%)
    - Duke Energy Generation Services Holding Company, Inc. (100%)
      - Duke Energy Generation Services, Inc. (100%)

Duke Energy Generation Services, Inc. (100%)(DE 6 2 2000)
- Cinergy Solutions Partners, LLC (100%)(DE 9 12 2000)
  - CST Limited, LLC (100%)(DE 5 18 2001)
    - CST Green Power, L P (99%)(DE 5 23 2001)
  - CST General, LLC (100%)(TX 5 22 2001)
    - CST Green Power, L P (1%)(DE 5 23 2001)
- CSGP General, LLC (100%)(TX 4 5 2001)
- CSGP Limited, LLC (100%)(DE 4 5 2001)
- DEGS O&M, LLC (100%)(DE 8 30 2004)
- DEGS of Delta Township, LLC (100%)(DE 12 15 2004)
- DEGS of Lansing, LLC (100%)(DE 6 25 2002)
- DEGS of Narrows, LLC (100%)(DE 3 17 2003)
- DEGS of Philadelphia, LLC (100%)(DE 5 11 2001)
- DEGS of San Diego, Inc (100%)(DE 1 9 2004)
- DEGS of Shreveport, LLC (100%)(DE 6 28 2002)
- DEGS of South Charleston, LLC (100%)(DE 8 24 2004)
- DEGS of St Bernard, LLC (100%)(DE 1 6 2003)
- Duke Energy Industrial Sales, LLC (100%)(DE 6 6 2006)
- Oklahoma Arcadian Utilities, LLC (40 8%)(DE 12 5 2000)
- Shreveport Red River Utilities, LLC (40.8%)(DE 10 16 2000)

Changes to Corporate Structure: 1st Quarter 2012

Entities Removed

RE Bellflower LLC (100%)(DE 12 8 2009) – merged effective 2 23 2012
RE Fontana 2 LLC (100%)(DE 12 8 2009) – merged effective 2 23 2012
RE Irvine LLC (100%)(DE 11 30 2009) – merged effective 2 23 2012
RE San Diego LLC (100%)(DE 12 17 2009) – merged effective 2 23 2012
Attiki Denmark ApS (51%)(Denmark 10 1 2000) – dissolved effective 3 6 2012
Attiki Gas Supply Company S A (49%)(Greece 11 2 2001) – sold effective 3 6 2012
CinCap IV, LLC (10%) (DE 12 3 1997) – cancelled effective 1 17 2012
Cinergy Origination & Trade, LLC (100%)(DE 10 19 2001) – cancelled effective 1 17 2012
CinFuel Resources, Inc. (100%)(DE 1 10 2002) – dissolved effective 2 23 2012
CinPower I, LLC (100%)(DE 6 12 1998) – cancelled effective 3 8 2012
DEGS of Monaca, LLC (100%)(DE 12 16 2003) – cancelled effective 3 5 2012
Duke Broadband, LLC (100%) (DE 9 22 2003) – cancelled effective 1 17 2012
Duke Capital Partners, LLC (100%)(DE 3 14 2000) – cancelled effective 2 27 2012
Generadora del Pacifico, Limitada (Guatemala 4 9 2008) – dissolved effective 3 6 2012
LH1, LLC (1%)(DE 1 10 2002) – cancelled effective 2 23 2012
Oak Mountain Products, LLC (100%)(DE 7 9 2001) – cancelled effective 2 23 2012
Spruce Mountain Investments, LLC (1%)(DE 11 8 2006) – cancelled effective 2 27 2012
Spruce Mountain Products, LLC (100%)(DE 10 27 2006) – cancelled effective 2 23 2012
Teak Mountain Products, LLC (100%)(DE 5 1 2007) – cancelled 2 27 2012
Willow Mountain Products, LLC (100%)(DE 5 1 2007) – cancelled 2 23 2012

Entities Added

Free State Windpower, LLC (100%) formed in DE on 2 1 2012
Panoche Valley Solar LLC (25%) formed in DE on 3 13 2012

Entities Restructured

Cimarron Windpower II, LLC (100%)(DE)was contributed down to Free State Windpower, LLC on 2 28 2012 by DEGS Wind I, LLC
Ironwood Windpower, LLC (100%)(DE) was contributed down to Free State Windpower, LLC on 2 28 2012 by Ironwood-Cimarron Windpower Holdings, LLC

Name Changes

Duke Energy Transmision Guatemala Limitada (100%)(Guatemala 10 1 2001) changed its name to Duke Energy International Guatemala Transco Limitada on 1 4 2012
Ironwood Windpower Holdings, LLC (100%)(DE 12 8 2010) changed its name to Ironwood-Cimarron Windpower Holdings, LLC on 2 16 2012

Duke Energy Kentucky (DEK) is responsible for the transmission, distribution, and sale of electricity energy and the sale and transportation of natural gas in northern Kentucky. Its parent company is Duke Energy Ohio (DEO), which is engaged in the production, transmission, distribution and sale of electricity and the sale and transportation of natural gas in the southwestern portion of Ohio. Cinergy Corporation is the parent holding company of Duke Energy Indiana, Inc., Duke Energy Ohio, Inc., and Cinergy Investments, Inc.[3]

The DEK Board is comprised of three directors, who hold officer positions within DEK, DEO, and Cinergy, as follows:[4]

- DEK Financial Officer, DEO Chief Financial Officer, Cinergy President
- DEK Chief Legal Officer, DEO Group Executive & Chief Legal Officer, Cinergy Group Executive & Chief Legal Officer
- DEK Chief Executive Officer, DEO Chief Executive Officer

Transactions

Services

Exhibit II-9 displays affiliate charges (associated with non-power goods and services) from/to DEK for 2009 to 2011.[5]

Exhibit II-9
Affiliate Service Charges
2009 to 2011

From Affiliates to DEK

	2009	2010	2011	
DEBS	$74,470,263	$73,366,239	$81,570,068	(A)
DEO	$11,441,842	$16,177,815	$14,557,361	(B)
DEI	($11,836)	$616,933	$623,628	(C)2009/(E)2010 and 2011
DEC	$17,940	$3,292	$22,548	(C)
DEGS	$17,007	$0	$0	(C)
DE Commercial Enterprises	$0	$638,341	$712,690	(D)
Total	**$85,935,216**	**$90,802,620**	**$97,486,295**	

From DEK to Affiliates

	2009	2010	2011	
DEBS	$462,705	$190,463	$94,507	(F)
DEO	$3,064,447	$2,569,111	$3,218,494	(G)
DEI	$1,485,399	$1,383,559	$948,811	(H)
DEC	$44,497	$57,150	$4,844	(I)
Duke Energy One	$34,527	$5,544	$42,982	(J)2009/(I)2010
KO Transmission	$40,983	$20,066	$137,653	(I)
Duke Energy Investments	$0	$4,094	$0	(I)
Total	**$5,132,558**	**$4,229,987**	**$4,447,291**	

From Affiliates to DEK:
(A) Service company transactions to DEK
(B) DEO employees provide services to DEK for Miami Fort Unit 6 Woodside generating stations, O&M/capital services for electric T&D systems, O&M/capital services for gas distribution system, and other goods or services
(C) Other goods or services
(D) For generating stations and other goods or services
(E) DEI employees provides services to DEK for O&M/capital services for generation stations, O&M/capital services for electric T&D systems, and other goods or services
From DEK to Affiliates:
(F) DEK transactions to service company
(G) DEK employees provide services to DEO for O&M/capital services for the electric T&D systems, O&M/capital services for the gas distribution system, and other goods or services
(H) DEK employees provide services to DEI for administration, training, and support services at various combustion turbine sites: O&M/capital services for electric T&D systems, and other goods or services
(I) Other goods or services
(J) DEK employees provide services to Duke Energy One for equipment installation, T&D construction and maintenance

Source: Information Response 3

According to Duke Energy management, the primary reasons for increases are (a) direct expenses from Demand Side Management (DSM) programs, in addition to increased capital costs, and (b) allocated costs attributable to the increasing common Smart Grid costs allocated across participating jurisdictions.[6]

Convenience Payments

Convenience payments (also referred to at Duke Energy as pass through costs) typically include:[7]

- Finance and accounting services
- Insurance premium expense
- Advertising expense
- Community relations projects
- Donations
- Employee benefits expense
- Dues/subscriptions
- Signage/publications/printing
- Research and development
- Miscellaneous lease/rent expense

Exhibit II-10, for example, illustrates convenience payments involving revenues recorded by the Commercial Power segment of Duke Energy Ohio for charges to Duke Energy Kentucky for 2009, 2010, and 2011.[8]

Exhibit II-10
Convenience Payments
2009 to 2011

From DEO to DEK			
Description	**2009**	**2010**	**2011**
Equipment Leases between DEO and DEK	$444,924	$1,578,608	$1,105,356
Step-Up Transformers (East Bend, Woodsdale & Miami Fort)	$1,933,776	$1,933,776	$1,933,776
Transmission Expenses from MISO	$1,238,783	$987,938	$998,177
Total	**$3,617,483**	**$4,500,322**	**$4,037,309**

Source: Information Response 45

Personnel Transfers

Exhibit II-11 displays personnel transfers from/to DEK for 2009 to 2011.[9]

Exhibit II-11
Affiliate Personnel Transfers
2009 to 2011

From Affiliates to DEK				
From Company	**2009**	**2010**	**2011**	**Total**
DEBS	7	4	10	21
Duke Energy Ohio	11	8	9	28
Total	**18**	**12**	**19**	**49**

From DEK to Affiliates				
To Company	**2009**	**2010**	**2011**	**Total**
DEBS	23	13	11	47
Duke Energy Ohio	4	7	3	14
Duke Energy Indiana			1	1
Total	**27**	**20**	**15**	**62**

Source: Information Response 4

Asset Transfers

Exhibit II-12 displays asset transfers from/to DEK for 2009 to 2011.[10]

Exhibit II-12
Affiliate Asset Transfers
2009 to 2011

From Affiliates to DEK	2009	2010	2011
Inventory Stock	$1,054,674.42	$4,203,952.66	$6,360,327.56
Meters			
Electric	$279,149.80	$191,331.45	$476,686.70
Gas	$63,932.58	$0.00	$69,154.36
Transformers	$304,522.28	$591,601.09	$609,626.56
Regulators	$0.00	$0.00	$0.00
Other Miscellaneous Items	$3,703,167.60	$218,684.29	$0.00
Total	**$5,405,446.68**	**$5,205,569.49**	**$7,515,795.18**

From DEK to Affiliates	2009	2010	2011
Inventory Stock	$27,833.12	$271,383.42	$515,182.57
Meters			
Electric	$552,387.00	$171,422.19	$125,311.31
Gas	$219,616.87	$0.00	$205,185.81
Transformers	$15,289.68	$99,325.12	$0.00
Regulators	$8,873.00	$0.00	$0.00
Other Miscellaneous Items	$7,014.50	$22,928.50	$0.00
Total	**$831,014.17**	**$565,059.23**	**$845,679.69**

Source: Information Response 5

According to Duke Energy management, the reason for the continually increasing asset transfers of inventory from affiliates to DEK is primarily due to the location of a recon facility in Ohio that serves both Ohio and Kentucky.[11]

Separation

One of the expectations specified in affiliate relationships and transactions rules has to do with the physical separation of regulated and unregulated business and the sharing of information and assets between these entities. In fact, Kentucky regulatory standards provide the following guidelines shown in *Exhibit II-13*.[12]

Exhibit II-13
KRS 278.2213 Separate recordkeeping for utility and affiliate -- Prohibited business practices -- Confidentiality of information -- Notice of service available from competitor
as of December 31, 2011

The provisions of this section shall govern a public utility company's activities related to the sharing of information, databases, and resources between its employees or an affiliate involved in the marketing or the provision of nonregulated activities and its employees or an affiliate involved in the provision of regulated activities.

1. A utility and its affiliate shall be separate corporate entities and maintain separate books and records. If a utility and nonregulated affiliate have common officers, directors, or employees, the fees, compensation, and expenses of the individuals involved shall be subject to the cost allocation requirements set forth in KRS 278.2203 and 278.2207. Any utility that provides nonregulated activities shall separately account for all investments, revenues, and expenses in accordance with its filed cost allocation manual.
2. A utility shall not provide advertising space in its billing envelope to its affiliates or for its nonregulated activities unless it offers the same to competing service providers on the same terms it provides to its affiliates. This subsection applies to nonregulated activities only.
3. A utility shall not attempt to persuade customers to do business with its affiliates by offering rebates or discounts on tariffed services.
4. All utility company employees engaged in the merchant function shall abide by all standards promulgated by applicable FERC orders and regulations.
5. No utility employee shall share any confidential customer information with the utility's affiliates unless the customer has consented in writing, or the information is publicly available or is simultaneously made publicly available.
6. All dealings between a utility and a nonregulated affiliate shall be at arm's length.
7. Employees transferring from the utility to an affiliate shall not disclose to the affiliate confidential information or take with them any competitively sensitive materials.
8. Neither a utility nor its employees or agents shall solicit business on behalf of an affiliate or for its nonutility services.
9. A utility that carries out any research and development or joint marketing and promotion with its affiliate for its nonregulated activities shall be subject to the cost allocation requirements set forth in KRS 278.2203.
10. Except as provided in subsection (5) of this section, if a utility is engaged in a nonregulated activity, marketing employees for the nonregulated activity shall not have access to the customer information provided to the utility when the customer places an order for regulated service.
11. A utility shall not provide any type of undue preferential treatment to a nonregulated affiliate to the detriment of a competitor.
12. A utility shall notify the customer that competing suppliers of a nonregulated service exist if:
    a. The utility receives a request for a recommendation from a customer seeking a specific service which is offered by the utility's affiliate or by the utility itself; and
    b. The utility mentions itself or its affiliate when making the recommendation to the customer.
13. The utility's name, trademark, brand, or logo shall not be used by a nonregulated affiliate in any type of visual or audio media without a disclaimer. The commission shall develop specifications for the disclaimer. The disclaimer shall be approved by the commission prior to use in any advertisement by the utility's affiliate.
14. A utility shall not enter into any arrangements for financing nonregulated activities through an affiliate that would permit a creditor upon default to have recourse to the assets of the utility.
15. A utility shall inform the commission of all new nonregulated activities begun by itself or by the utility's affiliate within a time to be set by the commission.
16. Start-up costs associated with the formation of a nonregulated affiliate shall not be included in the utility's rate base.
17. The commission may require the utility to file annual reports of information related to affiliate transactions when necessary to monitor compliance with these guidelines.

Source: KRS 278.2213

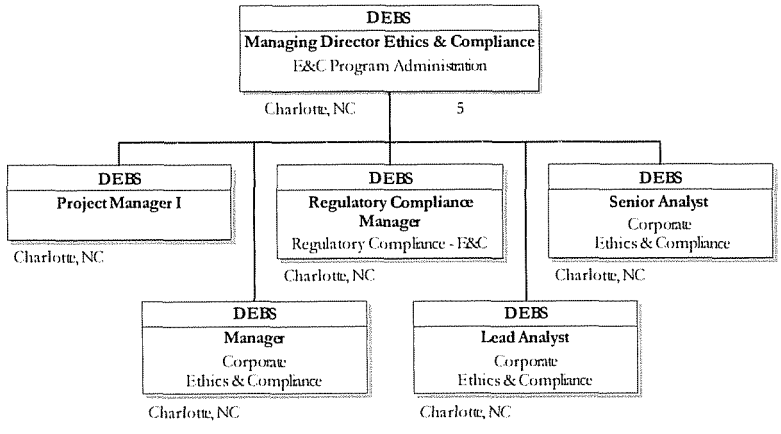
This section discusses Schumaker & Company's findings regarding compliance to the above non-accounting items in the Kentucky standards.

Ethics & Compliance Organization

Exhibit II-14 illustrates the DEBS Ethics & Compliance group, totaling five employees in Charlotte (NC), reports to Audit Services, and in turn the Chief Legal Officer. The two Regulatory Compliance employees are responsible for state and federal regulatory compliance, including:[13]

- State and federal regulatory requirements
- Monitoring regulatory compliance policies and procedures
- Providing guidance, such as affiliate standards training and advice, to Duke Energy employees in regulatory compliance matters

Exhibit II-14
Ethics & Compliance Organization
as of December 31, 2011



Source: Interview 8

The Open Pages system is used to track compliance issues, such as merger conditions, filings, or system access reviews, in which ownership of these issues is also kept.[14] The Regulatory Compliance Manager handles any requests for clarification on Kentucky Affiliate Rules training requirements.[15]

Other Organizations

Also, Duke Energy currently has two separate organizational groups that are responsible for regulated and unregulated power functions:[16]

- The regulated electric business is located in Charlotte (NC). All of the offerings of generation resources into MISO and the requesting of day-ahead load requirements are handled from the

Operations Center located in Charlotte. The individual regulated generation units are dispatched from the Charlotte Operations Center and all trading activities are handled in the Charlotte Operations Center. Regulated wholesale sales are also handled in Charlotte. The Operations Center is split between the Carolinas and Midwest (Kentucky and Indiana) organizations.

- The unregulated electric business is located in Cincinnati (OH). All of the offerings of generation resources into PJM Interconnection, LLC (PJM) and Midwest Independent System Operator (MISO) and the requesting of day-ahead load requirements are handled from the Operations Center located in Cincinnati. The individual regulated generation units are dispatched from the Cincinnati Operations Center and all trading activities are handled in the Cincinnati Operations Center. Wholesale sales are also handled in Charlotte. The Operations Center handles the dispatching of the former Duke Energy Ohio generating plants, which are unregulated assets.

DEK power transactions are handled out of Charlotte (NC) by a group of traders and dispatchers that only handle Kentucky and Indiana power transactions. There is a separate group of traders and dispatchers that handle the Carolinas power transactions in Charlotte (NC).[17]

All affiliated wholesale power transactions are handled at the organization in Cincinnati, Ohio. Duke Energy Kentucky has approximately 15 affiliated wholesale power marketers. DEK's affiliated wholesale power marketers are:[18]

- CinCap IV, LLC (CinCap IV) is a Delaware limited liability company headquartered in Cincinnati (OH), which during the test period marketed electricity at wholesale pursuant to market-based rate authority granted by the Federal Energy Regulatory Commission (FERC). On July 20, 2011 the FERC accepted CinCap IV's notice of cancellation requesting that the FERC cancel its market-based rate tariff. CinCap IV did not own any generation or transmission facilities.
- CinCap V, LLC (CinCap V), is a Delaware limited liability company (LLC) headquartered in Cincinnati (OH), which markets electricity at wholesale pursuant to market-based rate authority granted by the FERC. CinCap V does not own any generation or transmission facilities.
- Duke Energy Commercial Asset Management, Inc. (DECAM), is a Delaware corporation headquartered in Cincinnati (OH), which serves as the wholesale merchant agent for a number of generation and marketing businesses within Duke Energy Corporation's commercial business segment. DECAM has been granted authorization to sell power at market-based rates by the FERC. DECAM does not own any generation or transmission facilities, but is parent to entities that own 3120 nominal megawatts (MW) of gas-fired merchant generation.
- Duke Energy Commercial Enterprises, Inc. (DECE), an Indiana corporation headquartered in Cincinnati (OH), is the parent of Duke Energy Retail Sales, LLC and CinCap V, as well as certain other companies that do not own generation or transmission facilities. DECE has been

granted authorization to sell power at market-based rates by the FERC. DECE does not own any generation or transmission facilities.

- Duke Energy Retail Sales, LLC (DER), a Delaware limited liability company headquartered in Cincinnati (OH), is a competitive retail electric service (CRES) provider certified by the Public Utilities FERC of Ohio and engages in wholesale power transactions to facilitate its CRES provider business operations. DER owns no generation or transmission facilities. The FERC has granted DER market-based rate authority.
- Duke Energy Trading and Marketing, L.L.C. (DETM), a Delaware limited liability company headquartered in Cincinnati (OH) during the test period, marketed electricity at wholesale pursuant to market-based rate authority granted by the FERC. On July 20, 2011 the FERC accepted DETM's notice of cancellation requesting that the FERC cancel its market-based rate tariff. DETM did not own any generation or transmission facilities.
- St. Paul Cogeneration, LLC (St. Paul Cogen), a Minnesota limited liability company headquartered in St. Paul (MN), owns a biomass-fired cogeneration facility with an electric generating capacity of 35 MWs (nameplate) located in St. Paul, Minnesota. St. Paul Cogen has been granted market-based rate authority and qualifying facility status by the FERC.
- Happy Jack Windpower, LLC (Happy Jack), a Delaware limited liability company headquartered in Cincinnati (OH), owns a 29.4 MW (nameplate) wind-powered electric generation facility located approximately eight miles west of Cheyenne, Wyoming. Happy Jack has been granted market-based rate authority and exempt wholesale generator status by the FERC.
- North Allegheny Wind, LLC (North Allegheny), a Delaware limited liability company headquartered in Cincinnati (OH), owns a 70 MW (nameplate) wind-powered electric generation facility located in Cambria and Blair Counties (PA). North Allegheny has been granted market-based rate authority and exempt wholesale generator status by the FERC.
- Three Buttes Windpower, LLC (Three Buttes), a Delaware limited liability company headquartered in Cincinnati (OH), owns a 99 MW (nameplate) wind-powered electric generation facility located in western Converse County (WY). Three Buttes has been granted market-based rate authority and exempt wholesale generator status by the FERC.
- Silver Sage Windpower, LLC (Silver Sage), a Delaware limited liability company headquartered in Cincinnati (OH), owns a 42 MW (nameplate) wind-powered electric generation facility located approximately eight miles west of Cheyenne, Wyoming. Silver Sage has been granted market-based rate authority and exempt wholesale generator status by the FERC.
- Kit Carson Windpower, LLC (Kit Carson), a Delaware limited liability company headquartered in Cincinnati (OH), owns a 51 MW (nameplate) wind-powered electric generation facility located in Kit Carson County (CO). Kit Carson has been granted market-based rate authority and exempt wholesale generator status by the FERC.
- Top of the World Wind Energy, LLC (Top of the World), a Delaware limited liability company headquartered in Cincinnati (OH), owns a 200.2 MW (nameplate) wind-powered electric

generation facility located in western Converse County (WY). Top of the World has been granted market-based rate authority and exempt wholesale generator status by the FERC.

- Duke Energy Lee II, LLC (Lee II), a Delaware limited liability company headquartered in Cincinnati (OH), owns a 640 MW (nameplate) natural gas-fired electric generation facility located in Dixon (IL). Lee II is a wholly owned subsidiary of DECAM. Lee II has been granted market-based rate authority and exempt wholesale generator status by the FERC.
- Duke Energy Hanging Rock II, LLC (Hanging Rock II), a Delaware limited liability company headquartered in Cincinnati (OH), owns a 1240 MW (nameplate) natural gas-fired electric generation facility located in Ironton (OH). Hanging Rock II is a wholly owned subsidiary of DECAM. Hanging Rock II has been granted market-based rate authority and exempt wholesale generator status by the FERC.
- Duke Energy Washington II, LLC (Washington II), a Delaware limited liability company headquartered in Cincinnati (OH), owns a 620 MW (nameplate) natural gas-fired electric generation facility located in western Beverly (OH). Washington II is a wholly owned subsidiary of DECAM. Washington II has been granted market-based rate authority and exempt wholesale generator status by the FERC.
- Duke Energy Fayette II, LLC (Fayette II), a Delaware limited liability company headquartered in Cincinnati (OH), owns a 620 MW (nameplate) natural gas-fired electric generation facility located in Masontown (PA). Fayette II is a wholly owned subsidiary of DECAM. Fayette II has been granted market-based rate authority and exempt wholesale generator status by the FERC.
- Duke Energy Vermillion II, LLC (Vermillion II), a Delaware limited liability company headquartered in Cincinnati (OH), owned an undivided 75% interest in a 640 MW (nameplate) natural gas-fired electric generation facility located in Vermillion County (IN) (also referred to as the facility). Vermilion II is a wholly owned subsidiary of DECAM. During the test period, Vermillion II had been granted market-based rate authority and exempt wholesale generator status by the FERC. In January 2012, pursuant to FERC authorization, Vermillion II transferred its ownership interest in the Facility to Duke Energy Indiana, Inc. (DEI) and Wabash Valley Power Association, Inc. (WVPA), with DEI and WVPA subsequently owning 62.5% and 38.5% of the facility, respectively. In March 2012, the FERC accepted Vermillion II's notice of cancellation requesting that the FERC cancel its market-based rate tariff.

The activities of the above wholesale affiliates are coordinated out of the Duke Energy Commercial Asset Management, Inc. (DECAM) in Cincinnati (OH). The employees of the affiliated wholesale power marketer(s) (located in Cincinnati) operate independently of the employees responsible for Duke Energy Kentucky's wholesale merchant and generation functions (located in Charlotte).[19]

There is also no space occupied by Duke Energy Kentucky and non-regulated affiliated wholesale power marketers as defined. These two organizations operate independently.[20] Schumaker & Company confirmed these statements by physical observations during our interviews.[21]

Competitive or Sensitive Information

When asked to provide any formal policies or procedures documentation regarding access by Duke Energy Kentucky and any affiliate to competitive or sensitive information, a copy of Duke Energy's *Affiliate Restrictions – Information Disclosure Procedures* was provided. Its purpose is to provide a process for handling the disclosure of regulated market information to market regulated power sales affiliates. Specific procedures include:[22]

- Legal shall be notified if regulated market information is shared with non-regulated merchant employees, or if there are deviations from separation of functions, including in emergency instances.
- Legal will determine whether to make a posting of such information on its web site or a filing with the Commission, using procedures similar to those used for Standards of Conduct disclosures (see "Duke Energy FERC Page").
- Legal or Regulatory Compliance will meet with the business unit involved in the inappropriate disclosure to discuss and offer recommendations to mitigate future occurrences. This information (which may include compliance measures) will be maintained by Regulatory Compliance.

Automatic reminders are sent annually through compliance software to the responsible organization.[23]

Training materials used by Duke Energy's or Duke Energy Kentucky's employees on sharing of competitive or sensitive information and/or sharing of office space, computers, or any other assets includes the following:[24]

- Midwest (Kentucky, Indiana, and Ohio) State Regulatory Requirements for Non-regulated Products and Services *MyTraining* (completed by 94 Duke Energy employees and contractors in May and June of 2011), including but not limited to:[25]
  - The affiliate must be fully separated.
  - The affiliate must have separate accounting treatment.
  - The affiliate must not be given an unfair competitive advantage or be extended any undue preference by the utility (meeting guidelines, proprietary customer information/customer consent, customer leads/referrals, appropriate/inappropriate responses, etc.)
  - A code of conduct should be established that satisfies the commission rules.
- Duke Energy Kentucky Expectations for Customer Care guidelines[26]
- Quick Reference Guide – State Regulatory Requirements – Non-regulated Products & Services comparison chart of Indiana, Kentucky, Ohio, and Carolinas.

Transfer Confidentiality Agreements

The Regulatory Compliance group manages and facilitates the employee transfer process from DEK to an affiliate. Identified individuals (and their managers) who transfer from the utility to an affiliate are required to complete and confirm that they have reviewed system access, physical access, and email distribution lists. Also, automated emails are forwarded to impacted managers with required actions items.[27]

Training

The affiliate standards training has been developed across Duke Energy and modified slightly for each state based on the specific requirements of that state. The content of training differs due to slightly different Affiliate Rules in Kentucky, although they are very similar to Ohio rules. One difference is that DEK is required to specifically report asset transfers $1 million or more to the KPSC, but no similar differences regarding service charges involving Kentucky.[28]

Affiliate Rules compliance training is combined for OH/KY, not just because DEO owns DEK, but also due to the amount of overlap among participants for OH/KY requirements. The Ohio Corporate Separation-Kentucky Affiliate Rules training, which was developed in-house, is conducted annually for any Duke Energy employees deemed to be impacted by Affiliate Standards requirements. Starting in 2010, it was deployed electronically. Previously it was classroom-based training. At the end of 2011, approximately 551 of Duke Energy's approximately 18,000 employees were required to participate. Notifications were made at the end of December 2011 via email message with follow-up messages and calls to employees and their supervisors to remind those who did not yet complete the training. To identify the employees required to participate in training, Duke Energy identifies a deployment list, which is reviewed annually. It will also be updated throughout the year, if necessary. Those identified are not just Service Company employees but anyone within the Duke Energy organization whose function is likely to be impacted by Affiliate Rules requirements.[29]

The focus of this training is threefold, as follows:[30]

- Discuss why guidance regarding affiliate relationships is important, including risks if not followed.
- A direct description of what that means.
- A reminder that, if employees have questions, who they should contact for further guidance.

Other relevant training provided in 2011 was (a) affiliate asset transfer training, including compliance with federal and state pricing rules, (b) FERC affiliate restrictions and standards of conduct, and (c) large business training, which includes discussions about affiliate interactions.[31]

- The focus of the affiliate asset transfer training is primarily employees in the supply chain/plant inventory functions and includes an overview of the following:

- Understand federal and state rules that govern affiliate asset transfers
- Affiliate asset transfer agreements for regulated affiliates
- Affiliate asset transfer process & eForm requirements
- Understand consequences of non-compliance
- Understand employee's role to ensure compliance

- The focus of the FERC affiliate restrictions and standards of conduct training and case study is fairly broad (involving approximately 8,500 employees) and includes an key FERC requirements, such as:
  - Market information from the regulated utility should not be shared with non-regulated employees (employees who work on behalf of the non-regulated affiliates).
  - Non-regulated employees and regulated employees should operate separately.
  - Regulated and non-regulated utility affiliates cannot sell energy or capacity to each other without FERC approval.
  - FERC asymmetrical pricing rules apply to goods and service transactions between the regulated utility and the non-regulated utility/non-utility affiliates, unless there is an exception.

  This training is administered annually to individuals who are either *directly or indirectly* impacted by the Affiliate Restriction or Standards of Conduct requirements administered by FERC. In support of this training session is a comprehensive 96-page FERC compliance manual.[32]

- Also, in 2011, 94 participants received training regarding sharing of competitive or sensitive information and/or sharing of office space, computers, or any other assets.[33]

Ethics Line

Additionally, Duke Energy has an ethics line that allows employees to call in, anonymously if they like, any concerns that they have, although the company has also added a compliance reporting mailbox (compliancereporting@duke-energy.com), which is focused on compliance issues. Duke Energy encourages employees to use the mailbox for any questions or concerns that employees have with regarding to compliance issues, but they can use either the ethics line or the mailbox. Advertisements for the ethics line and mailbox include posters in buildings and mention in code of business and affiliate training sessions.[34]

B. Findings & Conclusions

Affiliate Agreements

Finding II-1 **Appropriate affiliate agreements were in place for 2011, but are now out-of-date, as the Duke Energy/Progress Energy merger has been approved during 2012.**

Exhibit II-15 summarizes existing affiliate agreements impacting Duke Energy Kentucky.[35]

Exhibit II-15
Existing Affiliate Agreements (Page 1 of 4)
as of December 31, 2011

Merger-Related Service Agreements			
Agreement	**Agreement Description**	**Effective**	**Compensation**
Service Company Utility Agreement	Duke Energy Corporation, Cinergy Corp, Duke Energy Business Services, LLC, and other various utility (Duke Energy Carolinas, Duke Energy Indiana, Duke Energy Kentucky, Duke Energy Ohio, and Miami Power Corporation) companies involving Duke Energy Business Services, LLC functions: information systems; meters; transportation; system maintenance; marketing/ customer relations; T&D engineering/construction; power engineering/ construction; human resources; materials management; facilities; accounting; power and gas planning and operations; public affairs; legal; finance; rates; rights of way; internal audit; environmental, health, and safety; fuels procurement; investor relations; planning; and executive.	September 1, 2008 (second amendment)	Cost except otherwise required by IRS 482
Operating Companies Service Agreement	Duke Energy Carolinas, Duke Energy Indiana, Duke Energy Kentucky, Duke Energy Ohio, and Miami Power Corporation involving services (including loans of employees), such as engineering/construction; operation/maintenance; installation services; equipment testing; generation technical support; environmental, health, and safety; and procurement services; plus use of assets, equipment, and facilities. It specifically excludes affiliate transactions involving sales or other transfers of assets, goods, energy commodities (electricity, natural gas, coal, and other combustible fuels), or thermal energy products.	May 18, 2010 (third amendment)	Cost based only; with DEC and DEO exceptions
Operating Company/Non-Utility Companies Service Agreement	DEK/various Duke Non-Utility companies involving services (including loans of employees), such as: ◆ *DEK to Non-Utility:* engineering/construction; operation/maintenance; installation services; equipment testing; generation technical support; environmental, health/safety; and procurement services; plus use of assets, equipment, and facilities. ◆ *Non-Utility to DEK:* Technology services; monitoring, surveying, inspecting, constructing, locating, and marking of overhead and underground utility facilities; meter reading materials management; vegetation management; and marketing/customer relations.	September 1, 2008 (amended and restated)	Cost based only

Source: Information Response 8

Exhibit II-15
Existing Affiliate Agreements (Page 2 of 4)
as of December 31, 2011

Other Affiliate Agreements			
Agreement	**Agreement Description**	**Effective**	**Compensation**
Asymmetrically -Priced Duke Energy Kentucky/Non -Utility Companies Service Agreement	Duke Energy Kentucky/various Duke Non-Utility companies involving services (including loans of employees), such as: ◆ *DEI to Non-Utility* – engineering/construction; operation and maintenance; installation services; equipment testing; generation technical support; environmental, health, and safety; and procurement services; plus use of assets, equipment, and facilities. ◆ *Non-Utility to DEI* – information technology services; monitoring, surveying, inspecting, constructing, locating, and marking of overhead and underground utility facilities; meter reading materials management; vegetation management; and marketing and customer relations.	October 1, 2009	FERC pricing mechanism
Intercompany Asset Transfer Agreement	Duke Energy Carolinas (DEC), Duke Energy Indiana (DEI), Duke Energy Kentucky (DEK), and Duke Energy Ohio (DEO) asset transfers, in which "assets" means parts inventory, capital spares, equipment and other goods except for the following: coal; natural gas; fuel oil used for electric power generation; emission allowances; electric power; and environmental control reagents.	December 22, 2008	Except to the extent otherwise required by Section 482 of the Internal Revenue Code or analogous state tax law, Recipient Operating Company shall compensate Transferor Operating Company for any assets transferred at cost; provided however that any transfers of electric generation-related assets between DEO, on the one hand, and DEI or DEK on the other hand, will be priced in accordance with FERC affiliate transaction pricing requirements. *
*	Accordingly, generation-related assets transferred from Duke Energy Indiana or Duke Energy Kentucky to Duke Energy Ohio shall be priced at the greater of cost or market, and generation-related assets transferred from Duke Energy Ohio to Duke Energy Indiana or Duke Energy Kentucky shall be priced at no more than market. Alternatively, to the extent that an asset may be transferred under this Agreement, the Transferor and Recipient may agree that the asset transferred to the recipient be replaced in kind.		

Source: Information Response 8

Exhibit II-15
Existing Affiliate Agreements (Page 3 of 4)
as of December 31, 2011

Agreement Title	Agreement Description	Effective Date	Compensation
Utility-Non-Utility Asset Transfer Agreement	Duke Energy Kentucky/Non-Utility asset transfers, in which "assets" means parts inventory, capital spares, equipment and other goods except for the following: coal; natural gas; fuel oil used for electric power generation; emission allowances; electric power; and environmental control reagents.	January 1, 2009	Except to the extent otherwise required by Section 482 of the Internal Revenue Code or analogous state tax law, a Recipient party under this Agreement shall compensate the Transferor for any assets transferred in accordance with the FERC affiliate transaction pricing requirements. Accordingly, assets transferred from DEI to a Non-Utility Company shall be priced at the greater of cost or market, and assets transferred from a Non-Utility Company to DEI shall be priced at no more than market. Alternatively, to the extent that an asset may be transferred under this Agreement, the Transferor and Recipient may agree that the asset transferred to the Recipient be replaced in kind.
Utility Money Pool Agreement	A money pool arrangement to manage cash and working capital requirements in which those companies with surplus short-term funds provide short-term loans to affiliates (other than Duke Energy and Cinergy) participating under this arrangement.	November 1, 2008 (second amendment)	Depends on if internal and/or external fund used.

Source: Information Response 8

Exhibit II-15
Existing Affiliate Agreements (Page 4 of 4)
as of December 31, 2011

Amended and Restated Purchase & Sale Agreement with Cinergy Receivables	Allows the operating companies (DEI, DEO, and DEK) to sell their retail accounts receivables to this affiliate.	October 27, 2010	Fair market value of receivable on initial funding date
Agreement for Filing Consolidated Income Tax Returns and for Allocation of Consolidated Income Tax Liability and Benefits	Tax liability is allocated to Duke Energy subsidiaries on the basis of the percentage of the total tax which the tax of such an entity, if computed on a separate return, would bear to the total amount of the taxes for all entities.	October 1, 2008 (first amendment)	
Generation Acquisition Service Level Agreements (SLAs)			
Facilities Operation Agreement	Permits DEK to utilize DEO-owned transmission facilities and equipment to provide service from DEK's generating stations	September 27, 2004 (as amended) DEK is in the process of acquiring ownership of transformers covered by the generation step-up (GS) agreement between DEO and DEK; agreement is scheduled for cancelled on or about May 8, 2012 once the GSU transfer takes place.	Described in other agreement.
Miami Fort 6 Operations Agreement	Permits DEO to operate the Miami Fort 6 generating station, including procurement of fuel, on behalf of DEK.	January 1, 2006	Described in other agreement.
Gas & Propane Services Agreement	Permits DEO to provide certain operations and maintenance support to DEK related to the natural gas and propane facilities at the Woodsdale generating station.	January 24, 2009	Described in other agreement.
Other Service Level Agreements			
Agreement for Gypsum Waste Material Disposal Services	DEO pays DEK a market price for generator waste disposal services; because it follows Kentucky's affiliate pricing rules, Commission approval was not necessary.	April 24, 2007	$21.95/ton

Source: Information Response 8

None of these agreements became effective in 2011, but all were in effect during the year. As the Duke Energy/ Progress Energy merger became effective in 2012, DEK is required to submit updated versions of agreements to the Kentucky Public Service Commission.

Affiliate Training

Finding II-2 **DEK's Affiliate Rules training for 2011 indicates a few instances where individuals had not completed training within a timely manner.**

Beginning in 2011, all impacted employees involving Ohio, Kentucky, and Indiana operations were required to attend Affiliate Standards training sessions via Duke's online Learning Management System (*MyTraining*). During 2011, 551 employees and contractors were scheduled for Ohio/Kentucky-related training course. They were typically notified in late December 2011 (December 30, 2011), and were expected to complete training within 60 days (by March 1, 2012).[36] Approximately 10 days earlier (December 21, 2011), group executives for impacted business organizations were notified. The day when the employees/contractors are notified is considered *Day 1*. Approximately 30 days later (*Day 30*), a reminder is sent. On *Day 50*, if someone has not viewed the eLearning slides and passed the exam, then another reminder is sent to the individual and to his/her manager, plus a report is sent to the HR VP and SVP. Not participating in training (and passing the exam) within 60 days is considered non-compliance. On Day 61, an overdue notification is sent to the individual and his/her manager, plus a report is sent to the HR VP, SVP, and group executive. These notifications and reports continue until all employees and contractors supposed to take the training have completed it.[37] Of these 551 participants, all had completed training, although 49 had a completion date after March 1, 2012 (24 in March 2012, 16 in April 2012, and 9 in May 2012).[38]

Benchmarking

Finding II-3 **Duke Energy frequently performs various benchmarking studies as a means to compare costs to market values for services performed.**

Duke Energy Corporation's last full benchmarking exercise results were produced in 2010 based on 2009 costs and services. The company typically likes to benchmark in alternate years to allow improvement initiatives to manifest in the results; however, it did not conduct a benchmark in 2011 due to the amount of effort focused on merger analysis.[39]

Recent benchmark studies performed by Duke Energy include the following:[40]

2009 Market and Cost Allocation Study

Ernst & Young LLP (EY) performed a Market and Cost Allocation study of the services provided by Duke Energy Business Services and Duke Energy Shared Services to Duke Energy Carolinas for the period ending December 31, 2008, which was completed in September 2009.[41] Of the 23 services

provided by the Service Company, one was largely outsourced (4%), one was immaterial (4%), four were strategic in nature (18%), eight had no comparable market data (35%), and nine (39%) were evaluated using benchmarking data. The benchmarking data indicated that only one service, Information Systems, was above the median benchmark for some portions. It should be noted that benchmarks cannot be considered alone or without context as circumstances of peer organizations differ. Therefore, Duke Energy management believes that benchmark results should be viewed as a point of reference and significant variances should be considered based on the facts and circumstances of the organizations being benchmarked. Due to the inherent limitations of benchmarking data, it cannot be used as the sole basis for making an assessment on market value.[42]

The procedures included conducting a series of structured interviews with key business personnel as well as Service Company employees. To analyze costs, EY obtained Duke Energy detailed data files and supporting documentation for costs charged to Duke Energy Carolinas. At the request of Duke Energy Carolinas EY co-developed a cost allocation framework to calculate the fully distributed costs of each service. For market comparables, EY identified vendors who, based on Duke Energy's input, could provide services currently performed by Service Company employees. EY analyzed publicly available information for these vendors to analyze market pricing. Based upon the procedures performed, EY documented if reasonable market comparables could not be found for certain services or if a service had been excluded from analysis of market comparables due to business or strategic reasons. For the majority of services, EY noted that the level of activities provided by the Service Company for each service could not be easily replicated by one vendor, as part of the standard services offered by the vendor. Additionally, without obtaining detailed pricing information from vendors that aligned to the services provided by the Service Company, market comparables were not readily available. The consensus of the project team, which consisted of staff from Service Company, EY, and subject matter resources in an advisory capacity, was that this sort of solicitation for information from third parties would not be appropriate for a number of reasons, as outlined in the report.[43]

In conjunction with the Cinergy merger integration project, the majority of Services performed an analysis to assess which functions could be outsourced to a third party provider. Each of these assessments considered a number of function specific factors, but cost was always considered as part of this analysis. Subsequent to the integration project, services were challenged to review costs annually and consider any cost-savings of outsourcing. As of December 31, 2008, approximately 50% of non-Executive Services were either outsourced or directly purchased.

EY's research also indicated that no utility in Duke Energy's or Duke Energy Carolinas' peer group had outsourced, in totality, as much as Duke Energy. Actual cost comparisons to peers utilities by service for 2008 were not possible as this level of information was no longer required to be filed on FERC Form 60. As such, comparability of costs between utilities using available 2007 FERC Form 60 information was not possible.[44]

Where benchmarking information was available from qualified independent sources, it was utilized to compare the cost of services provided by the Service Company to the cost of comparable services incurred by other organizations. The results of benchmarking analysis were used to help organizations

set the direction to develop its strategy in specific process areas. Similar to the constraints noted above in using FERC Form 60 information, benchmarking information did not provide details on the actual functions provided within each service. Benchmarking data was also impacted by many company specific factors including the complexity of the organization, competencies and skill sets of personnel, use of technology, etc.[45]

Also, the external benchmarking EY used was based on all industries and was not specific to the utility industry. It was recognized that the utility industry has a number of specific regulatory and operating requirements which impact its comparability with other industries. Additionally, Duke Energy Carolinas operates in a regulated environment, where revenues were based on a cost plus model. The analysis indicated that on average, Duke Energy Carolinas rates were 33% less on average than its peers.[46]

2009 UNITE Benchmark Results (Corporate IT Organization)

Through UNITE, a cooperative effort among energy service providers, Duke Energy generally participates in an annual Information Technology research and analysis aimed at identifying areas of improvement and sharing best practices, although the last UNITE study was in 2009, in which the benchmarking exercise enlisted 17 utility companies from across the United States, making up approximately half of the country's energy generation. The UNITE consortium provided members with an avenue to compare their IT costs and services across functional towers in relation to other companies. UNITE's approach gathered annual benchmark data from each member company, comparing results across peer utilities and against previous years. The comparative analysis helped identify cost savings and improvement opportunities through informed best practice discussions.[47]

Duke Energy's merger with Cinergy and the sequential consolidation efforts that followed impacted the data gathered for the 2008 UNITE benchmarking study. For instance, Duke Energy had significantly higher spending in some areas due to the operation of dual systems and increased baseload costs due to new projects going into production. Nearly all of Duke's total spend and unit cost amounts reported for the 2009 UNITE study decreased when compared to the numbers submitted for the 2008 study; this decrease in expenses represented the clarity gained through new procedures aimed at accurate inclusion of the Midwest.[48]

Other Studies

Selected other benchmarking studies were performed in the last three years, which indicated that Duke Energy costs were reasonable, as follows:

- 2010 Aviation Department study[49]
- 2011 Event Planning study[50]
- 2012 Building Owners & Managers Association (BOMA) Experience Exchange Report (EER) study of building costs (OH/KY district offices only)[51]

Additionally, for Security Services in 2008, the company reviewed fossil generation security labor costs per megawatt of generation, as follows:[52]

- Worst - $646
- Benchmark - $438
- Best - $284

Enterprise Protective Services (EPS) security labor costs were within the peer industry average. In 2012, EPS recalculated the data with new data available and the cost moved to $293, which is closer to industry best.[53]

Duke Energy also has the *Confidential Consortium Metrics Analysis 2011* data report, which is a benchmark report for a utility consortium, including Duke Energy created by an outside utility consulting firm. This benchmark contains information that is farther reaching than costs and service competitiveness as it also measures certain HR criteria that may not fit into this description. Additionally, the report does not compare Duke Energy individually to the overall consortium.[54]

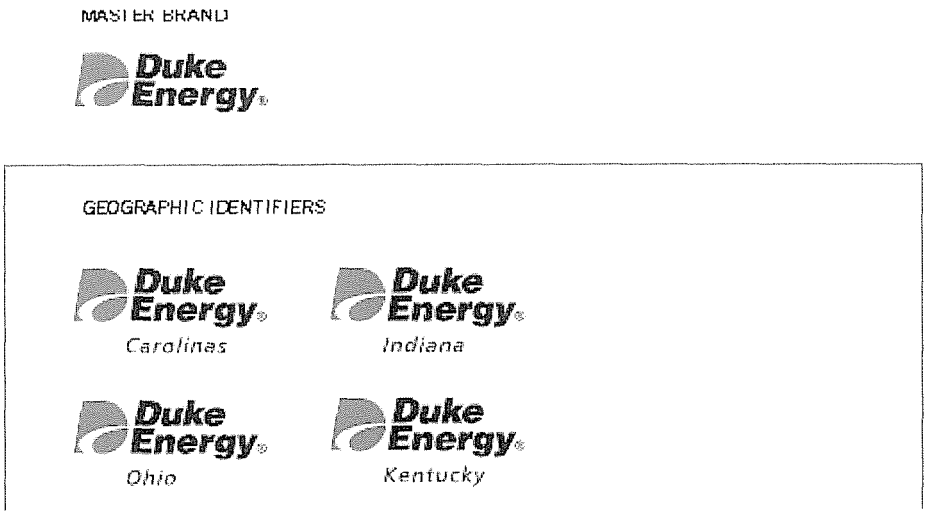
There was also a market assessment of Duke Energy Corporation Human Resources Department created by Aon Hewitt and KPMG.[55]

Separations

Finding II-4 There was no use of the DEK logo by any non-utility affiliate.

The Duke Energy Kentucky Logo is shown *Exhibit II-16.*[56]

Exhibit II-16
Duke Kentucky Logo



Source: Information Response 54

The Ohio Corporate Separation-Kentucky Affiliate Rules training materials indicate that DEK must not allow a non-regulated affiliate to use DEK's name, trademark, or logo in any type of visual or audio media without a disclaimer approved by the Kentucky Public Service Commission (KPSC) prior to use in any advertisement by DEK's affiliate. The Director, Duke Energy One (DEOne) (also called Customer Sales & Delivery) (whose responsibilities include directing the regulated and non-regulated sales and delivery efforts and providing additional value-added products and services for large commercial and industrial customers) is not familiar with any requirement in Kentucky for a disclaimer or a signed/dated copy of commission approval when the utility's name, trademark, brand, or logo is used by any non-regulated affiliate in any type of visual or audio media. However, he attests that the standard practice is to utilize the company-approved DEOne logo rather than the DEK logo for any visual or audio media.[57]

Finding II-5 **There is no office space shared occupied by Duke Energy Kentucky and non-regulated affiliated wholesale power marketers.**

Duke Energy management has attested that there is no space occupied by Duke Energy Kentucky and non-regulated affiliated wholesale power marketers, nor any sharing of assets except computer systems. There are systems that are shared between Duke Energy Kentucky and the non-regulated affiliated

wholesale power marketers, but there are controls in place to prevent information and data sharing, as these two organizations operate independently. Examples of such controls include:[58]

- Compliance tracking of system access for employees having state and federal affiliate implications, in which business unit (BU) owners are identified, access level is verified, and attestations are required – each on an annual basis.
- Training sessions as previously discussed in interview session.
- Physical access limitations; especially with regard to Kentucky no shared access exists.

In addition, in the corporate physical access guidelines, personnel are also required to sing a visitor log for FERC restricted areas. As per the procedure, a visitor log is made for all individuals that are escorted into the secured areas.[59]

Finding II-6 **There are some shared computer systems between by Duke Energy Kentucky and non-regulated affiliated wholesale power marketers, but they are controlled via passwords and other access permissions.**

There are systems that are shared between the non-regulated affiliated wholesale power marketers and the regulated wholesale power marketers. These systems have all been identified and access to each is controlled via passwords and other access permissions. Information systems used by Duke Energy Kentucky have been included in a System Inventory Access Review process. The review of access and associated processes is accomplished via a compliance tool, Open Pages, which has the capability of reminding and documenting that the owners/administrators of the various systems complete a review of system access on an annual basis (sometimes more frequently).[60]

In response to information requests, DEK provided a listing of shared information systems and the security measures used to assure the confidentiality of customer and other information. The systems that are shared by regulated and non-regulated users have firewall separation and/or separate passwords for regulated and non-regulated users. Employees requesting system access are required to submit an eForm and/or email to the system administrator through the employee's manager. Both the manager and administrator must approve prior to granting access to the system.[61]

Filings

Finding II-7 **Filings were made with the KPSC during 2011 as required in the merger commitments approved by the KPSC on November 29, 2005.**

Duke Energy Kentucky is required to give the KPSC 30 days advance notice of any changes in cost allocation methodologies and justifications in the amount and methodology. Cost allocation methodologies are noted to be established in several DEK documents in the merger commitments agreed to in 2005. These are the 1) Service Company Utility Service Agreement, 2) Operating Company / Nonutility Companies Services Agreements, 3) Operating Company Service Agreements.[62]

On April 4, 2011, DEK filed the following affiliate contracts with the KPSC in compliance with the above commitment.[63]

- Service Company Utility Service Agreement
- Operating Companies Service Agreement
- Intercompany Asset Transfer Agreement
- Agreement for Filing Consolidated Income Tax Returns and for Allocation of Consolidated Income Tax Liabilities and Benefits
- Utility Money Pool Agreement

The Operating Company / Nonutility Companies Services Agreements is not listed above as a contract filed with the KPSC in April 2011, as it was not changed as a part of the Duke / Progress Energy merger. Duke Energy Kentucky is only required to file for any changes in cost allocation methodologies and, therefore, this agreement was not included in that group of contracts filed.[64]

C. Recommendations

Recommendation II-1 **Update affiliate agreements with the Kentucky Public Service Commission. (Refer to Finding II-1)**

As the Duke Energy/ Progress Energy merger became effective in 2012, DEK is required to submit updated versions of agreements to the Kentucky Public Service Commission. It has not done so at the time of field work completion for this audit, but Duke Energy management indicates that it will be done as part of the next annual filing.

Recommendation II-2 **Aggressively send notifications to employees who have not passed affiliate rules training even before the Day 50 currently used. (Refer to Finding II-2)**

For 2013, Duke Energy anticipates implementing a more aggressive, proactive reminder schedule for its Ohio/Kentucky affiliate rules training program. For example, Duke Energy management indicates that individuals who are required to participate in the training program will now:

- Receive reminders at 30 days, 20 days, and 10 days prior to the March 1 deadline.
- Be sent four past due notices will be sent on a weekly basis to employees who fail to complete the training program by the March 1 deadline.

So as many employees as possible who are required to participate in affiliate rules training do so by the March 1 deadline, Duke Energy should ensure that it implements these plans to accelerate its Day 50 reminders and increase usage of past due notices.

III. Affiliate Transactions and Cost Accumulation and Assignment

A. Background & Perspective

The Duke Energy accounting system is Financial Management Information System (FMIS), a PeopleSoft system with general ledger, accounts receivable, accounts payable, asset management, project costing (i.e., Power Plant), contract, and billing applications, plus feeder systems that also pass information to the general ledger. The FMIS processes charges to/from Duke Energy Business Service (DEBS) and Duke Energy Kentucky affiliates.[65]

The system has a terminology and method of operation, and each uses a code block/chart field that comprises a set of elements that classify financial information. The code block/chart field contains multiple elements that describe five aspects of a financial transaction as follows:[66]

- When – defines the timing of the work performed
- Who – identifies who performed the work on whose behalf
- What – defines the nature of the work performed
- How – defines the resource used to perform the work
- Where – identifies the location the work was performed or performed for

The corporate organization is broken down into thousands of responsibility centers, which roll up into other higher level responsibility centers based on reporting responsibility. FMIS uses responsibility center (RC) codes to designate parties to a transaction. FMIS records an accounting entry for a direct charge transaction by designating an RC code that represents the work group performing the service and an Operating Unit (OU) code that represents the group for which the work was performed. The OU To code can be specific or not; for example, it can designate a particular plant or just fossil/hydro plants in general. The business unit receiving the charge designates the OU code to which the amount should be charged. The accounting entry also includes an account, process, project number, resource type (*e.g.*, labor, materials, outside contractor), and amount; the FERC account number is usually embedded in the accounting code block numbering. For allocated charges, the OU code represents an allocation pool, such as governance or enterprise accounting. The FMIS system processes allocation pools at month-end, distributing the charges according to the appropriate allocation pool percentages.[67]

Methodologies Used

Description of Transactions

Services

For all cross affiliate services provided, an eForm, which is the same form throughout Duke Energy, is required. This process has been in place for approximately six years.[68]

Among the duties of the Allocations & Employee Benefits group is the reasonability for developing and maintaining a basis data binder used to allocate Service Company costs and tracking and reporting Service Company allocations to receiving departments, as well as answering requests from individual departments. The basis data used for developing allocation factors for a calendar year is updated annually based on the 12 months of actual results ending the prior June 30th of each year. The only exception is for basis data involving capital expenditures (Electric T&D Engineering & Construction and Power Engineering & Construction), which the capital budget data for the upcoming year. June 30 data is available and used to update the basis data in the July through September time frame, so this data can be used to complete the budget for the upcoming year.[69]

As shown later in *Exhibit III-3*, Duke Energy uses approximately 20 factors for allocating Service Company costs.[70] The allocation factors used do not change often because the methodologies have been agreed to and included in the various Service Company agreements. Adding a methodology/factor would require modifying the agreement documents and getting buy-in from the various states and regulatory bodies. A major change in business operations, such as the merger with Cinergy, causes the methodologies (and the service agreements) to be modified. The real test of the methodologies used rests with the owners of the function. They have a vested interest in how the allocations are calculated and how much is allocated to affiliates in an area.[71] A good example of different charge allocations using the same factor ratio is the Human Resources function based on number of employees ratio in which (a) governance activities are charged to all entities, including small portion to the international affiliates); (b) enterprise HR only is charged to all affiliates, except international ones, and (c) Utilities HR is charged only to the regulated industries.[72]

The Service Company is basically a net $ entity, in which most costs are charged to Duke Energy subsidiaries; exceptions include DEBS income tax, which is not allocated, and selected interest charges that remain with the Service Company entity.[73]

Departmental employees are directed to direct charge if they can and only include their costs in the allocation pools if they cannot direct charge. Duke Energy's time reporting system, *MyTime*, which has been used approximately two years, was fully implemented on an enterprise basis in April 2011. The time reporting system has a default for employees' time and it is charged unless changed. According to DEBS management, employees were trained to use the new system when it was implemented, so all employees should know how to change their time from the default.[74]

Timekeepers enter time into *MyTime* from approved employee timesheets, or in some areas the employee enters time into *MyTime* and the data is approved by the manager or delegate. The time data is extracted and exported to Aon Hewitt for biweekly pay processing through a series of programs, which loads the time data to the individual employee pay sheets in its HRMS system. Once the time data from *MyTime* has been processed to the individual employee pay sheets, a series of pay calculations occur in the payroll system to finalize the check process. Following the pay confirmation process, files are generated from the payroll system for processing through the Labor Distribution System (LDS). Aon Hewitt balances the labor files before sending the files and control totals to Duke Energy for labor distribution processing to the general ledger. All exempt employees are required to enter their vacation taken into *MyTime* and each business unit determines other time reporting requirements for their area. Some employees enter actual time data, while other employees have their time data generated based on their standard schedule and their default labor allocation. The time data, both entered and generated, is extracted and exported to LDS for processing to the general ledger.[75]

For allocated charges, one of the following three methodologies is used for recording intercompany transactions:[76]

- *Auto-generating:* Intercompany transactions required for recording loans, cash sweeps, or that generate the booking of revenue and generation of a receivable where both affiliates are on the enterprise PeopleSoft ledger may be recorded using the auto-generating methodology. It only handles US$ transactions; therefore, any non US$ transactions are exempt from using this methodology. This methodology automatically generates the *purchaser/receiver* transaction based on the *seller/sender* transaction and is available to all Duke Energy business units using the enterprise PeopleSoft general ledger.
- *Automated Crossbill*: Intercompany transactions that are required for recording allocations or expense/revenue transfers between corporate/business units are to be recorded using the automated crossbill methodology. Allocations or expense/revenue transactions recorded using this methodology may be recorded to third-party accounts rather than designated intercompany accounts as long as individuals responsible for the transaction ensure the propriety of the effect to the consolidated financial statement line items. The PeopleSoft system automatically generates the related receivable or payable to intercompany accounts.
- *Manual Balancing*: Although manual balancing is not the preferred methodology for recording inter-business unit transactions, manual balancing can be used when deemed necessary. Examples include: intercompany transactions that are required for recording investment/equity, intercompany derivatives, non-US$ transactions or, in the case where the transaction is with an affiliate who is not on the enterprise-wide PeopleSoft general ledger. Prior to recording inter-business unit transactions using the manual balancing methodology, both the *seller/sender* and *purchaser/receiver* must submit a request for approval (including the reason for using this methodology and documentation of the mitigating controls in place to ensure compliance with policy) to the Enterprise Intercompany Process Owner (IPO), defined as the person who is in the role of IPO for all of Duke Energy Corporation and its consolidated subsidiaries.

Duke Energy management confirms that its activity in FERC accounts 145 (Notes Receivable from Affiliates), 146 (Accounts Receivable from Affiliates), 233 (Notes Payable to Affiliates), and 234 (Accounts Payable to Affiliates) represents the entire population of transactions between Duke Energy Indiana and its affiliates regarding affiliate service charges.[77] *Exhibit III-1* illustrates a summary pricing guide for affiliate service charges.[78]

Exhibit III-1
Summary Pricing Guide
Services
as of December 31, 2011

		TRANSFER TO								
		DE Carolinas[1]	DE Indiana	DE Kentucky	DE Ohio (T&D)	Miami Power	DE Ohio (Gen)	other non-reg utility[3]	non-utility[4] (excl. Svc. Co.)	Service Company
TRANSFER FROM	DE Carolinas[1]		At Cost	At Cost	At Cost	At Cost	Higher Cost / Mkt	Higher Cost / Mkt	Higher Cost / Mkt	Higher Cost / Mkt
	DE Indiana	At Cost		At Cost	At Cost	At Cost	Higher Cost / Mkt	Higher Cost / Mkt	At Cost[7]	At Cost
	DE Kentucky	At Cost	At Cost		At Cost	At Cost	Higher Cost / Mkt	Higher Cost / Mkt	At Cost[7]	At Cost
	DE Ohio (T&D)	At Cost	At Cost	At Cost		At Cost	At Cost	Higher Cost / Mkt	At Cost[7]	At Cost
	Miami Power	At Cost	At Cost	At Cost	At Cost		Higher Cost / Mkt	Higher Cost / Mkt	At Cost[7]	At Cost
	DE Ohio (Gen)	Lower Cost / Mkt	Lower Cost / Mkt[2]	At Cost[5]	At Cost	Lower Cost / Mkt		Negotiated Rates	At Cost[7]	At Cost
	other non-reg utility[3]	Lower Cost / Mkt	Lower Cost / Mkt[2]	Lower Cost / Mkt	Lower Cost / Mkt	Lower Cost / Mkt	Negotiated Rates	Negotiated Rates	Negotiated Rates	Negotiated Rates
	non-utility[4] (excl. Svc. Co.)	Lower Cost / Mkt	At Cost[7]	At Cost[7]	At Cost[7]	At Cost[7]	At Cost[7]	Negotiated Rates	Negotiated Rates	Negotiated Rates
	Service Company	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	

Footnotes:

1: DE Carolinas has pricing thresholds above which pricing must be at the higher / lower of cost or market depending on the direction of the transaction rather than "At Cost" with Affiliated Regulated Utilities. These thresholds are individual service transactions > $100K and cumulative annual transactions > $6.5mm. For Services ONLY if these thresholds are exceeded, asymmetrical pricing must be applied but a separate legal agreement is not required as is the case for Asset Transfers.

2. The IRUC requires DE Indiana to follow FERC's asymmetrical pricing rules. However, since several of the Duke regulated utilities must follow more restrictive state pricing rules, it has been recommended that DEI affiliate transfers be priced at the more restrictive pricing.

3. Non-Regulated Utility Affiliates currently include: DEO-Generation, *St. Paul Cogeneration, DE Trading & Marketing,* Duke Energy Commercial Asset Management, Inc, CinCap IV, CinCap V, Duke Energy Commercial Enterprises Inc., Happy Jack Windpower, North Allegheny Wind, Silver Sage Wind, Three Buttes Windpower LLC., Kit Carson Windpower, LLC., Top of the World Windpower, LLC , Duke Energy Retail Sales, Duke Energy Vermillion II, LLC, Duke Energy Lee, II, LLC, Duke Energy Hanging Rock II LLC and Duke Energy Fayette II, LLC.

4: *Non-Utility Affiliates* are all other affiliates not identified in footnote 3 or the regulated utilities: DE Carolinas, DE Indiana, DE Kentucky, DE Ohio (T&D) and Miami Power.

5. If the affiliate is NOT party to the service agreement in place prior to 3/30/09, Services Provided must be at the Higher of Cost / Mkt. Be certain a subsequent agreement is in place authorizing the services even at asymmetrical pricing.

6. FERC No Action Letter allows DEO Gen to provide services to DEK Plants (Woodsdale, EastBend, and Miami Fort Unit 6) at cost.

7. If the affiliate is NOT party to the service agreement in place prior to 3/30/09, Services Received must be at the Lower of Cost / Mkt. Be certain a subsequent agreement is in place authorizing the services even at asymmetrical pricing.

Source: Information Response 46

Asset Transfers

The FERC accounts in which asset transfers (e.g. utility, emission allowances, materials and supplies) between Duke Energy Kentucky (DEK) and its affiliates are recorded as follows:[79]

- *Utility Plant in Service*: 300 level electric plan accounts
- *Emission Allowances*: 158 emission allowance inventory account

- *Materials and Supplies*: Although transactions of materials and supplies could be recorded in capital accounts and O&M accounts, the following accounts were used in recording materials and supplies asset transfers between Duke Energy Kentucky and its affiliates in 2011:
  - 107000 Construction Work in Process
  - 154100 Plant Materials and Operating Supplies

The asset transfer rules for DEK and other Duke Energy utilities in the Midwest are different from the rules that govern asset transfers in the Carolinas. Transfers in the Carolinas require the use of eForms (a burdensome form that is needed to comply with specific regulations in the Carolinas). Because of the number of transfers within the Midwest, Duke Energy put in a process that did not require the use of eForms in these states. Duke Energy uses an IBM Maximo system, called EMax, to track inventory stock-to-stock transfers between entities. DEK generally carries a smaller amount of inventory stock on its books than the other Midwest entities. Transfers of in-service assets are tracked in other systems, typically PowerPlant, which DEK uses. Asset transfers typically occur fossil plant to fossil plant or nuclear plant to nuclear plant as the part needs are similar. Typical transfers are low cost items, such as pumps or valves, although (as shown in *Exhibit II-12*) transfers may also include meters, transformers, regulators, and other miscellaneous items, which are not considered inventory stock transfers.[80]

Additionally, any individual asset transfers involving DEK that are $1 million or higher must be reported to the KPSC for approval, as follows:[81]

- In KRS 278.218 (approval of commission for change in ownership or control of assets owned by utility) indicates the following:
  1) No person shall acquire or transfer ownership of or control, or the right to control, any assets that are owned by a utility as defined under KRS 278.010(3)(a) without prior approval of the commission, if the assets have an original book value of one million dollars ($1,000,000) or more and:
     a) The assets are to be transferred by the utility for reasons other than obsolescence; or
     b) The assets will continue to be used to provide the same or similar service to the utility or its customers.
  2) The commission shall grant is approval if the transaction is for a proper purpose and is consistent with public interest.
- Also, regarding the KPSC Order in Case No. 2008-122 DEK agreed to be bound by KRS 278.218 for transactions involving its gas utility assets.

Emax is used for inventory stock transfers (Account # 154-Plant Materials and Operating Supplies in the sending entity to Account # 154 in the receiving entity); at the end of the month an automatic charge from Account # 163 (Storage, Freight, and Handling) of the sending entity is also transferred to Account # 163 in the receiving entity.[82]

On a monthly basis, in the Midwest, Duke Energy generates a report from eMax and uses it to determine if fair market value is to be calculated and, where appropriate, book the differential between fair market value and cost to comply with asset transfer standards. The asset valuation of fair market value for the transfers is done in one of three ways:[83]

- If goods were acquired using a blanket purchase order, the value is the blanket average unit price (AVP).
- If not acquired using a blanket purchase order, Duke uses a recent purchase order (typically less than six months old but no longer than a year) cost for the item.
- If there is no purchase order, Duke will get quotes; there is no prescribed number of quotes that must be received.

Transfers of assets not in inventory, such as capital spares, are performed in PowerPlant by the Asset Accounting organization.[84] Similarly, on a quarterly basis, Duke Energy generates a report from PowerPlant, and uses it to if fair market value is to be calculated and, where appropriate, book the differential between fair market value and cost (original cost minus depreciation reserve equals net book value cost) to comply with asset transfer standards.[85]

Cost is handled automatically in the systems; market rate differentials must be handled via a journal entry. The reports for transfers, both inventory stock and in-service assets, go to the Manager, Asset Accounting and a General Ledger journal entry (multiple lines) is created, if necessary.[86] For transfers of in-service assets between regulated and non-regulated entities, rather than simply make a transfer, Asset Accounting retires the asset from the sending entity and adds it formally to the receiving entity, creating a salvage amount to reflect the market differential amount.[87]

Affiliate transfers of assets are governed by Federal Energy Regulatory Commission (FERC) 707 and asset transfer agreements. FERC 707 requires that transfers between regulated and non-regulated affiliates be priced using asymmetrical pricing. This requires that transfers from DEK to a non-regulated affiliate must be valued at the higher of cost or market, and transfers from non-regulated affiliates to DEK be valued at the lower of cost or market price, referred to as asymmetrical pricing. Therefore, if a transfer is regulated to non-regulated and a market value adjustment is needed, then a gain is added via a journal entry. Conversely if a transfer is non-regulated to regulated, an adjustment via a journal entry is made, if needed.[88] For regulated-to-regulated transfers, asymmetrical pricing is not required, but is done at cost.[89]

There's a No Action letter in Kentucky. In 2006 Duke Energy made a request to FERC, when it transferred Miami Fort Unit 6 from DEO (then CG&E) to DEK (then ULH&P), to allow inventory stock transfers at "at cost" rather than "asymmetrical pricing," even though they would be transferred from a non-regulated entity (DEO Miami Fort 7/8) to a regulated entity (DEK). If any inventory stock transfers go from DEK to DEO, however, "asymmetrical pricing" is required.[90]

Exhibit III-2 illustrates a summary pricing guide for affiliate asset transfers.[91]

Exhibit III-2
Summary Pricing Guide
Asset Transfers
as of December 31, 2011

TRANSFER FROM		TRANSFER TO						
		DE Carolinas[1A, 1B]	DE Indiana	DE Kentucky	DE Ohio (T&D)	DE Ohio (Gen)	other non-reg utility[3]	non-utility[4]
	DE Carolinas[5]		At Cost[1A]	At Cost[1A]	At Cost[1A]	Higher Cost / Mkt[1B]	Higher Cost / Mkt[1B]	Higher Cost / Mkt[1B]
	DE Indiana	At Cost[1A]		At Cost	At Cost	Higher Cost / Mkt	Higher Cost / Mkt	Higher Cost / Mkt
	DE Kentucky[6]	At Cost[1A]	At Cost		At Cost	Higher Cost / Mkt	Higher Cost / Mkt	Higher Cost / Mkt
	DE Ohio (T&D)	At Cost[1A]	At Cost	At Cost		At Cost	Higher Cost / Mkt	Higher Cost / Mkt
	DE Ohio (Gen)	Lower Cost / Mkt[1B]	Lower Cost / Mkt[2]	At Cost[7]	At Cost		Negotiated Rates	Higher Cost / Mkt
	other non-reg utility[3]	Lower Cost / Mkt[1B]	Lower Cost / Mkt[2]	Lower Cost / Mkt	Lower Cost / Mkt	Negotiated Rates	Negotiated Rates	Negotiated Rates
	non-utility[4] (excl. Svc. Co.)	Lower Cost / Mkt[1B]	Lower Cost / Mkt[2]	Lower Cost / Mkt	Lower Cost / Mkt	Lower Cost / Mkt	Negotiated Rates	Negotiated Rates

Footnotes:

1A: Goods may be transferred "At Cost" with utility affiliates DEI, DEK, DEO T&D, EXCEPT when the transaction cost > $100K or the cumulative annual "At Cost" service and asset transfers threshold of $8.5mm has been reached / exceeded, or a transmission transformer is involved. In these cases, as opposed to Services exceeding the thresholds, **LEGAL MUST BE CONTACTED so that a separate legal agreement can be developed and filed.** *All Goods Transfers >$ 1mm require SC Commission Approval.*

1B: Prior to transferring goods at the Higher of Cost / Mkt or receiving goods at the Lower of Cost / Mkt., DE Carolinas must file an agreement. CONTACT LEGAL.

2: The IRUC requires DE Indiana to follow FERC's asymmetrical pricing rules. However, since several of the Duke regulated utilities must follow more restrictive state pricing rules, it has been recommended that DEI affiliate transfers be priced at the more restrictive pricing.

3: Non-Regulated Utility Affiliates currently include: DEO-Generation, St. Paul Cogeneration, DE Trading & Marketing, Duke Energy Commercial Asset Management, Inc, CinCap IV, CinCap V, Duke Energy Commercial Enterprises, Inc., Happy Jack Windpower, North Allegheny Wind, Silver Sage Wind, Three Buttes Windpower, LLC, Kit Carson Windpower, LLC, Top of the World Windpower, LLC., Duke Energy Retail Sales, Duke Energy Vermillion II, LLC, Duke Energy Lee, II, LLC, Duke Energy Hanging Rock II LLC and Duke Energy Fayette II, LLC.

4: Non-Utility Affiliates are all other affiliates not identified in footnote 3 or the regulated utilities: DE Carolinas, DE Indiana, DE Kentucky, DE Ohio (T&D) and Miami Power. Confirmation must be made that they are party to the existing agreements, if not, CONTACT LEGAL.

5: Transfers from DE Carolinas involving an asset over $1 million must be approved by the SCPSC.

6: DE Kentucky cannot transfer assets valued at $1 million or more without prior approval of the KYPSC.

7: FERC *No Action Letter allows DEO Gen to provide services to DEK Plants at cost.*

Source: Information Response 46

Cost Accumulation, Assignment, & Allocation

When a DEBS employee of performs services for a client company, costs are to be directly assigned or allocated.[92] Duke Energy uses 20 factors, as shown in *Exhibit III-3*, for allocating Service Company costs.[93] The allocation factors used do not change often because the methodologies have been agreed to and included in the various Service Company agreements. Adding a methodology/factor would require modifying the agreement documents and getting buy-in from the various states and regulatory bodies. A major change in business operations, such as the merger with Cinergy, causes the methodologies (and the service agreements) to be modified. The real test of the methodologies used rests with the owners of the function. They have a vested interest in how the allocations are calculated and how much is allocated to affiliates in an area. A good example of different charge allocations using the same factor ratio is the Human Resources function based on number of employees ratio in which (a) governance activities are charged to all entities, including small portion to the international affiliates); (b) enterprise

HR only is charged to all affiliates, except international ones, and (c) Utilities HR is charged only to the regulated industries.[94]

Exhibit III-3
Allocation Factors
as of December 31, 2011

Factor	Utility	Non-Utility
Circuit miles of electric transmission lines	Yes	No
Construction expenditures	Yes	Yes
Electric peak load	Yes	Yes
Generating unit MW capability	Yes	Yes
Gross margin	Yes	Yes
Inventory	Yes	Yes
Labor dollars	Yes	Yes
Miles of distribution lines	Yes	No
Number of central processing unit (CPU) seconds	Yes	Yes
Number of customers	Yes	Yes
Number of employees	Yes	Yes
Number of information systems servers	Yes	Yes
Number of meters	Yes	No
Number of personal computer (PC) work stations	Yes	Yes
O&M expenditures	Yes	No
Procurement spending	Yes	Yes
Revenues	Yes	Yes
Sales	Yes	Yes
Square footage	Yes	Yes
Total property, plant, and equipment	Yes	Yes

Source: Information Response 8

For allocated services, the Service Company Utility Service Agreement prescribes 23 functions with their associated allocation methodologies, as follows:[95]

Exhibit III-4
DEBS Allocation Factors by Function
as of December 31, 2011

Information Systems	◆ Number of Central Processing Unit Seconds Ratio ◆ Number of Personal Computer Workstations Ratio ◆ Number of Information Systems Servers Ratio ◆ Number of Employees Ratio ◆ Three Factor Formula
Meters	◆ Number of Customers Ratio
Transportation	◆ Number of Employees Ratio ◆ Three Factor Formula
Electric System Maintenance	◆ Circuit Miles of Electric Transmission Lines Ratio ◆ Circuit Miles of Electric Distribution Lines Ratio
Marketing and Customer Relations	◆ Sales Ratio ◆ Number of Customers Ratio Electric Transmission & Distribution
Engineering & Construction	◆ Electric Transmission Plant Construction - Expenditures Ratio ◆ Electric Distribution Plant Construction - Expenditures Ratio
Power Engineering & Construction	◆ Electric Production Plant Construction - Expenditures Ratio
Human Resources	◆ Number of Employees Ratio
Materials Management	◆ Procurement Spending Ratio ◆ Inventory Ratio
Facilities	◆ Square Footage Ratio
Power Planning Operations	◆ Electric Peak Load Ratio ◆ Weighted Average of the Circuit Miles of Electric Distribution Lines Ratio and the Electric Peak Load Ratio ◆ Sales Ratio ◆ Weighted Average of the Circuit Miles of Electric Transmission Line Ratio and the Electric Peak Load Ratio ◆ Generating Unit MW Capability Ratio
Accounting	◆ Three Factor Formula
Public Affairs	◆ Three Factor Formula ◆ Weighted Average of the Number of Customers Ratio and Number of Employees Ratio
Legal	◆ Three Factor Formula
Rates	◆ Sales Ratio
Finance	◆ Three Factor Formula
Rights of Way	◆ Circuit Miles of Electric Transmission Lines Ratio
Internal Auditing	◆ Three Factor Formula
Environmental, Health and Safety	◆ Three Factor Formula ◆ Sales Ratio
Fuels	◆ Sales Ratio
Investor Relations	◆ Three Factor Formula
Planning	◆ Three Factor Formula
Executive	◆ Three Factor Formula

Source: Information Response 3

Billing Mechanisms

During Year

Most affiliate billing mechanisms (those using FMIS/PeopleSoft) are automatically performed at month-end (based on direct charges and allocations) with offsetting entries to the charging entity (A/R) and receiving entity (A/P). This information is rolled up and summarized, then sent to Treasury, who in turn moves monies between the associated bank accounts. If a Duke Energy entity is not using FMIS, then a check or wire transfer is typically made. For regulated entities, settlement is required monthly. For non-regulated entities, it is not done until a capital infusion is required.[96]

True-up Procedures

Labor and Overhead Items

The Duke Energy Financial Management Information System (FMIS) automatically applies labor loaders for fringe benefits, payroll taxes, unproductive time, incentives, and Service Company overhead (O/H) allocations, if charges from DEBS to an affiliate; Service Company O/H allocations, but other entity O/H allocations are used if a different entity. Accounting personnel enter into FMIS the percentage for each labor loader item each month. These rates typically remain constant for most of the year. Accounting personnel record actual costs for the four labor-related costs in separate accounts that they monitor to make sure that the rates it has been applying are staying in line with actual costs. They typically adjust loader rates in the fourth quarter to clear any residuals compared to actual costs.[97]

Late Journal Entries

Any journal entries recorded after the monthly allocations run are either manually allocated in the current month or recorded in the following month.[98] As Duke Energy employees can only enter JEs until the second business day following month-end, large items after the second business day are manually allocated, while small items may be delayed to the next month. At year-end, however, any missing items, regardless of size, must be manually allocated.[99]

B. Findings & Conclusions

Finding III-1 **The DEK cost allocation manual is missing key elements.**

Kentucky Revised Statutes (KRS) 278.22054 provides that any Kentucky utility engaged in non-regulated activities, which produce aggregate revenue exceeding the lesser of two percent (2%) of the utility's total revenue or one million dollars ($1,000,000) annually, shall develop and file a cost allocation manual (CAM) with the KPSC.[100] The DEK CAM is based solely on KPSC requirements; it does not include various elements, which would make it more useful, such as those discussed in the recommendation associated with this finding.[101]

Duke Energy Kentucky's 2011 CAM was developed during the first quarter of 2011 and the affidavit for the 2011 CAM is dated March 25, 2011. Subsequently Duke Energy Kentucky's 2012 CAM was developed during the first quarter of 2012 and the affidavit for the 2012 CAM is dated March 21, 2012. Consistent with KRS 278.2205, Duke Energy Kentucky revises its CAM periodically for material changes. DEK also conducts an annual comprehensive review during the first quarter of each year to determine if there are any changes (both material and non-material) that need to be reflected. Duke Energy Kentucky conducts this CAM review along with its preparation of various annual financial and statistical reports that are filed with the KPSC on or about March 31st of each year. These additional annual reports include, but are not limited to, vegetation and reliability, resource planning updates, non-regulated revenues, and other reports required pursuant to various KPSC Administrative proceedings.[102] The 2011 and 2012 changes reflect updates to the various reporting requirements of non-regulated activities; also typically the only items changing are the % for cost allocation details, not new steps.[103]

DEK's CAM includes the following segments:[104]

- Description of Duke Energy Corporation and Duke Energy Kentucky
- CAM requirements, including:
  - KRS 278.2205 (2) (a): A listing of regulated and non-regulated divisions within the utility (not applicable, as DEK does not have any non-regulated divisions).
  - KRS 278.2205 (2) (b): A listing of all regulated and non-regulated affiliates of the utility to which the utility provides services or products and where the affiliates provide non-regulated activities, as defined in KRS 278.010 (21) (CAM Appendix A, with further description in agreements)
  - KRS 278.2205 (2) (c): A listing of services and products provided by the utility, and identification of each as regulated or non-regulated, and the cost allocation methodology generally applicable to each category
  - KRS 278.2205 (2) (d): A listing of incidental, non-regulated activities that are subject to the provisions of KRS 278.2203 (4)
  - KRS 278.2205 (2) (e): A description of the nature of transactions between the utility and its affiliates
  - KRS 278.2205 (2) (f): For each Uniform System of Accounts (USofA) account and subaccount, a report that identifies whether the account contains costs attributable to regulated operations and non-regulated operations, including an identification of whether the costs are joint costs that cannot be directly identified; if allocated a description of the methodology used, which are subject to the provisions of KRS 278.2203
- Appendices
  - Listing of DEK affiliates
  - Incidental non-regulated revenue (2011)

- Kentucky revised statutes
- Affiliate agreements, including:
  - Utility/non-utility asset transfer agreement
  - Amended and restated operating company/non-utility companies service agreement
  - Asymmetrically priced DEK/non-utility companies service agreement
  - Second amended and restated operating companies service agreement
  - Second amended and restated service company/utility service agreement, including shared service cost distribution detail
  - Utility money pool agreement
  - Second amended and restated purchase and sale agreement (updated October 27, 2010) of receivables
  - Second amended agreement for filing consolidated income tax returns and for allocation of consolidated income tax liabilities and benefits
  - Intercompany asset transfer agreement, including a report of 2011 inventory transfers
- Operations agreements
  - Facilities operation agreement between Cincinnati Gas & Electric Company and Union Light Heat and Power Company
  - Miami Fort 6 operation agreement
  - Gas and propane services agreement with respect to Woodsdale generating station
  - Agreement for gypsum disposal services
- FERC affiliate transactions report
- FERC uniform system of accounts

Several key elements of a comprehensive CAM are missing from DEK's CAM, including (but not limited to) elements such as:

- Description of cost accumulation, assignment, and allocation (direct and allocated charges)
- Description of allocation methodologies and factors, including how calculated
- Policies, guidelines, and procedures
- Description of processes and systems used for affiliate charges; etc.

Finding III-2 Appropriate cost allocation factors are being used.

Three primary categories of cost allocations affect DEK and its affiliates, including:[105]

- Cost allocations from DEBS to DEK

- Cost allocations between DEK and DEO for common costs shared by both utility organizations
- Administrative and general (A&G) cost allocations between its gas and electric operations for both capital and expense accounts

Additionally DEK also provides various services and goods to and receives various services and goods from other regulated and non-regulated affiliates, as shown previously in *Exhibit II-9*.[106] The allocation factors used at Duke Energy are illustrated in *Exhibit III-3*, with those identified by function are illustrated in *Exhibit III-4*. Schumaker & Company's review of factors used by function indicate that appropriate allocation factors are being used.

Finding III-3 **Duke Energy Kentucky's dividend policy is generally reasonable, although in 2011 an extremely high dividend payout ratio occurred.**

The Duke Energy Corporation (parent company) targets a long-term payout to shareholders of approximately 65% to 70% of adjusted diluted earnings per share, subject to the approval of its Board of Directors. The operating subsidiaries, including Duke Energy Kentucky, are expected to mirror this policy over time, but have flexibility to vary their dividends to the parent company depending on capital structure requirements and capital spending needs. Duke Energy Kentucky's historical dividends are displayed in *Exhibit III-5*.[107]

Exhibit III-5
DEK Dividend Payout
2007 to 2011

	2007	2008	2009	2010	2011
Dividend/(Infusion)	($3.1)	$30.0	$0.0	$0.0	$135.0
Net Income	$33.5	$37.5	$28.1	$43.3	$24.3
Payout Ratio	N/A	80%	0%	0%	556%

Source: Information Response 12

As DEK had not paid a dividend to its parent since 2008, the dividend in 2011 reflects several years of earnings and cash flow. Duke Energy believed that DEK's capital structure had also become too heavily weighted on equity (approximately 59% equity prior to the dividend versus an approved regulatory capital structure comprised of 51% equity). Also, management indicates that since 2006 Duke Energy Kentucky's payout ratio has been approximately 97%; however, Duke Energy management indicates that this figure would be decreased substantially if the company were to undertake a significant capital expenditures program to meet new resource requirements or comply with environmental regulations.[108]

DEK has no royalty policy nor has it historically paid any royalties to the parent company or its affiliates.[109]

Finding III-4 **Appropriate levels of direct charging are generally occurring with regard to DEK's affiliate transactions.**

For 2011, as well as the prior two years each, the percentage of direct charges shown in *Exhibit III-6* illustrate that generally a large portion of charges were directly charged, not allocated charges.[110]

Exhibit III-6
Direct versus Allocated Affiliate Service Charges
2009 to 2011

From Affiliates to DEK			
DEBS			
	2009	**2010**	**2011**
Direct %	62.6%	65.1%	62.0%
Allocated %	37.4%	34.9%	38.0%
Other Affiliates			
	2009	**2010**	**2011**
Total Affiliate Charges ($)	**$11,464,953**	**$17,436,381**	**$15,916,227**
Direct %	66.1%	76.8%	69.2%
Allocated %	33.9%	23.2%	30.8%
From DEK to Affiliates			
DEBS			
	2009	**2010**	**2011**
Total Affiliate Charges ($)	**$462,705**	**$190,463**	**$94,507**
Direct	23.9%	28.0%	60.5%
Allocated	76.1%	72.0%	39.5%
Other Affiliates			
	2009	**2010**	**2011**
Total Affiliate Charges ($)	**$4,669,853**	**$4,039,524**	**$4,352,784**
Direct %	64.9%	61.7%	71.2%
Allocated %	35.1%	38.3%	28.8%

Source: Information Responses 3 and 6

In *Exhibit III-6* FERC Form 1 and FERC Form 60 figures were used for all but DEBS to DEK affiliate charges, which was based solely on FERC Form 60 figures, as FERC Form 1 and FERC Form 60 figures did not agree. Refer to *Finding III-5* for further discussion.

Finding III-5 **The groups developing FERC Form 1 and FERC Form 60 reports inappropriately result in different figures for DEBS to DEK charges.**

The USFE&G Accounting group is responsible for developing Duke Energy's FERC Form 1 and the Corporate Accounting is responsible for developing its FERC Form 60. Although each group uses the same database for its input to these reports, each group uses different queries against the database to

create their respective reporting results. As shown in *Exhibit III-7*, the FERC Form 60 results typically are larger by roughly $15.6 million to $27.5 million, depending on the year.[111]

Exhibit III-7
Reconciliation of FERC Reporting Results for DEBS to DEK Affiliate Charges
2009 to 2011

		2009	2010	2011	
Direct		$56,382,166.00	$65,636,157.00	$61,969,883.00	
Allocated		$33,719,221.00	$35,236,705.00	$37,953,883.00	
Total DEBS Charges to DEK		**$90,101,387.00**	**$100,872,862.00**	**$99,923,766.00**	**Ties to FERC Form 60**
			Reconciliating Summary Items		
DEK Benefits	(A)	$5,680,694.46	$5,266,424.98	$5,746,178.99	Pass through costs
DEK RCs	(B)	($23,027,531.54)	($22,236,393.65)	($15,715,686.52)	Pass through costs
Account Exclusions	(C)	$1,878,517.44	($7,673,631.10)	($8,456,294.30)	
VOP On Top JEs	(D)		($3,464,630.36)	$0.00	
Miscellaneous Difference	(E)	($162,804.00)	$601,607.00	$72,104.00	
		($15,631,123.64)	**($27,506,623.13)**	**($18,353,697.83)**	
Adjusted DEBS Charges, including Pass Throughs		**$74,470,263.36**	**$73,366,238.87**	**$81,570,068.17**	**Ties to FERC Form 1**

Responsibility Centers			2009	2010	2011
1404	Corporate Accounts	(B)	$352,310.98		
1501	Corp Client Executive Benefits	(B)	$181,344.29	$412,283.19	$96,998.84
3921	EHS - Indirect Allocations-OH	(B)	$50,738.06		
8937	Executive Rewards	(A)			$447,556.94
8357	Contra - Employee Svc Center	(A)	$75,272.48	$51,207.67	
8902	Executive Benefits	(A)	$46,176.39	$22,029.00	
8912	Employee Benefits	(A)	$5,559,245.59	$5,193,188.31	$5,298,622.05
S706	MW Chargeoffs	(B)	($5,127,660.72)	($3,306,351.60)	($3,340,937.61)
S711	Financial Op GL (RB4)	(B)	($18,484,264.15)	($19,342,325.24)	($12,471,747.75)
VPKE	VP/OC Kentucky Electric	(D)		($2,644,273.18)	
VPKG	VP/OC Kentucky Gas	(D)		($820,357.18)	

Source: Information Response 33

According to Duke Energy management, the FERC Form 60 includes charges using regulated and non-regulated accounts to DEK, while FERC Form 1 includes regulated accounts only.[112] In our discussions with the Corporate Accounting group the following information regarding the five items (A) through (E) was as follows:[113]

a. Amounts in DEK benefits item reflect convenience payments for benefits paid by DEBS on behalf of DEK (included in FERC Form 1 and excluded from FERC Form 60).

b. Amounts in DEK responsibility centers (RCs) are those DEBS RCs that are focused on Kentucky, but Corporate Accounting did not know why these were eliminated by the USFE&G Accounting group (excluded from FERC Form 1 and included in FERC Form 60).

c. Amounts in Account Exclusions are specific accounts within RCs (included in FERC Form 1 and excluded from FERC Form 60 in 2009, but excluded from FERC Form 1 and included in FERC Form 60 in 2010 and 2011).

d. Voluntary Opportunity Program (VOP), a severance package associated with the Duke Energy/Cinergy merger, which was incorrectly put to the wrong RC, so a manual (On Top) journal entry (JE) made (excluded from FERC Form 1 and included in FERC Form 60).

e. Immaterial line items not included above (excluded from FERC Form 1 and included in FERC Form 60 in 2009, but included in FERC Form 1 and excluded from FERC Form 60 in 2010 and 2011).

Exhibit III-8 illustrates the account differences for 2011 for the items shown above in *Exhibit III-7*.[114]

Exhibit III-8
FERC Form 60 and Form 1 Account Differences
2011

		2011 Account Differences		
		FERC Form 60	FERC Form 1	Total
154200	Limestone Inventory	$1,057,748.89		$1,057,748.89
242461	Prior Year Incentive Accrual	$3,652.16		$3,652.16
254401	DSM Energy Efficiency	($3,319,196.11)		($3,319,196.11)
407354	DSM Deferral - Electric		$2,742,037.96	($2,742,037.96)
407355	DSM Deferral - Gas		$963,418.73	($963,418.73)
407907	Regulatory Asset-Deferral Acct		$3,346,808.03	($3,346,808.03)
415530	Marketing Service Revenue		($589.02)	$589.02
418002	Nonop Rental Inc - Florence		($1,065,770.97)	$1,065,770.97
431002	Int Exp-Other		$138,420.00	($138,420.00)
454400	Other Electric Rents		($27,944.00)	$27,944.00
		($2,257,795.06)	**$6,096,380.73**	**($8,354,175.79)**

Source: Information Response 33

According to Duke Energy management, generally account differences relate to interest and/or non-regulated items, but once we have 2011 detailed differences, an information request will be made. However, it was clear from our interviews with Duke Energy management that the reasons for these discrepancies were not fully understood.

Finding III-6 Insufficient oversight occurs regarding affiliate charges to DEK.

According to the DEBS USFE&G group, it is not responsible for "auditing" charges from affiliates to DEK (or other regulated entities) or DEK to affiliates. This group only looks at monthly variances against budget.[115] Additionally, no DEK management is responsible for oversight of DEBS or other affiliate charges to Kentucky; only the DEK functions will be looking at charges, but it was not clear that they question affiliate charges.[116]

Finding III-7 Affiliate asset transfer training is not comprehensive.

The asset transfer training has fewer participants than the FERC training, because only focused on selected employees in supply chain/plant inventory areas, as accountants participate only in general overview training; in future possibly have accountants participate in both.[117]

In 2011, 29 Duke Energy employees completed affiliate asset transfer training, mostly from Engineering and Operations groups. The training list only included one Supply Chain employee and no Accounting or Rates employees.[118] In our interviews regarding asset transfers, we spoke with Supply Chain, Accounting, and Rates representatives, who told us asset transfer training for inventory stock-to-stock transfers was informally done. Instead, the responsibility for the Supply Chain, Accounting, and Rates employees to see that this is done correctly resides with the Director, Sourcing, who trains these employees on such tasks.[119]

Finding III-8 **Sufficient policy and associated documentation has not been available in past years regarding accounting for asset loans.**

Regarding asset loans, Duke Energy has started (in 2012) considering putting a value on asset loans, but did not value them in 2011. The thought is to use the Storage, Freight, and Handling cost (Account # 163) as the value of an asset loan. Duke Energy is also considering the use of the service eForm for services as management considers this more like a service (rental) than an asset transfer, especially for loans lasting less than three to four months. If it is longer than three to four months, then Duke Energy is considering selling the asset and buying it back on the associated entity's books. At this time, however, DEBS does not have a formal policy regarding asset loans nor sufficient documentation describing the proper accounting for such transactions.[120] Although no such loans occurred in 2011 involving asset loans from/to DEK, other Duke Energy entities, such as DEI, did have such a loan. Therefore, Duke Energy should ensure that its plans to develop a policy and create such procedural documentation go forward.[121]

C. Recommendations

Recommendation III-1 **Develop a formal comprehensive cost allocation manual that brings together all required elements of such documentation. (Refer to Finding III-1)**

Duke Energy Kentucky is in need of formal documentation, such as that used by Duke Energy Carolinas, which in one package with any associated appendices comprehensively describes its affiliate relationships/organization structure; affiliate standards to which it is subject; affiliate agreements; description of cost accumulation, assignment, and allocation (direct and allocated charges); allocation methodologies and factors; policies, guidelines, and procedures; description of processes and systems used for affiliate charges; etc.

Recommendation III-2 **Have one DEBS group perform both FERC Form 1 and FERC Form 60 reporting so as to eliminate discrepancies in reporting results. (Refer to Finding III-5)**

Schumaker & Company was unable during this audit to fully determine why the discrepancies existed between the FERC Form 1 and Form 60 reporting, as different groups developed each of the reports

and individuals from these groups did not fully understand why some of the discrepancies existed. To ensure that both reports are appropriately developed in the future, whereby discrepancies are avoided to the extent possible and fully understood, if necessary, one of these groups should be identified to develop both reports.

Recommendation III-3 **Have a DEK group responsible for oversight of affiliate charges to DEK. (Refer to Finding III-6)**

A key person within the DEK management group should be identified and be responsible for oversight of all charges from affiliates to DEK and vice versa. They should not only obtain input from the various DEK groups impacted by these charges, but also question any figures that do not appear appropriate, thereby requiring DEBS Accounting groups to investigate and change, if necessary.

Recommendation III-4 **Formalize asset transfer training for Supply Chain, Accounting, and Rates employees. (Refer to Finding III-7)**

As discussed previously, formal asset transfer training did not include all Duke Energy employees that should be included. For example, the training list few, if any, Supply Chain, Accounting, or Rates employees. Also, asset transfer training for inventory stock-to-stock transfers was informally done. Instead, the responsibility for the Supply Chain, Accounting, and Rates employees to see that this is done correctly resides with the Director, Sourcing, who trains these employees on such tasks. All Supply Chain, Accounting, and Rates employees who deal with any type of affiliate transactions should be formally trained, with annual updates performed, to ensure an understanding of issues involved and policies, procedures, and practices to be followed.

Recommendation III-5 **Develop formal policy and associated documentation regarding asset loans. (Refer to Finding III-8)**

Duke Energy should develop formal policy and associated written documentation describing how and why it handles asset loans among affiliates, as it has already begun performing such activities without this information.

IV. Financial Arrangement/Obligation Compliance

This chapter addresses financial arrangement/obligation between Duke Energy Kentucky (DEK) and its affiliates, including its parent organizations – Duke Energy Ohio (DEO), Cinergy Corporation (Cinergy), and Duke Energy Corporation (Duke Energy).

A. Background

The specific governing regulatory section that is addressed in this chapter is KRS # 278.2207 - Transactions between utility and affiliate – Pricing requirements – Request for deviation, as follows:

18. The terms for transactions between a utility and its affiliates shall be in accordance with the following
    a. Services and products provided to an affiliate by the utility pursuant to a tariff 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 (United States Department of Agriculture) USDA, Securities & Exchange Commission (SEC), or Federal Energy Regulatory Commission (FERC) approved cost allocation methodology.
    b. Additionally, services and products provided to the utility by an affiliate are to 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.
19. 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, but the utility has the burden of demonstrating that the requested pricing is reasonable. The commission may grant the deviation if it determines the deviation is in the public interest.
20. Nothing in this section should be construed to interfere with the commission's requirement to ensure fair, just, and reasonable rates for utility services.

Financial services and products provided to DEK by affiliates and provided by DEK to its affiliates consist of long-term and short-term debt and investments.

Long-term Debt

Long-term Debt Composition

Duke Energy Kentucky's long-term debt at the end of calendar year 2011 consisted of capital leases, first mortgage bonds, pollution control bonds, and unsecured debt totaling approximately $343 million. At the end of the same period DEK's affiliates, including its parents, Duke Energy Ohio and Duke

Energy Corporation, had similar types of long-term debt totaling approximately $20.2 billion. Details of the long-term debt for DEK and its affiliates at the end of 2011 are shown in *Exhibit IV-1.*[122]

Exhibit IV-1
Duke Energy Long-Term Debt
as of December 31, 2011

Entity	Balance ($000)
Duke Energy Kentucky	342,786
Duke Energy Business Services	122,168
Duke Energy Carolinas	9,273,976
Duke Energy Indiana	3,458,999
Duke Energy Ohio	2,212,317
Duke Energy Corporation	3,771,971
Duke Energy International	652,662
Duke Energy Generation Services	738,482
Total	**20,573,361**

Source: Duke Energy Debt Detail – LTD Schedule, Duke Energy Website

On December 1, 2011 DEK issued $50,000,000 worth of County of Boone, Kentucky Pollution Control Revenue Refunding Bonds with a maturity date of August 1, 2027, and bearing a floating interest rate tied to the one-month London Interbank Offered Rate (LIBOR) plus a changing margin amount that was dependent on DEK's current credit rating. Specifically, the rate was equal to 75% of the sum of one-month reserve LIBOR, plus an applicable margin determined by the credit ratings of the senior unsecured debt of DEK. One-month reserve LIBOR is calculated by dividing LIBOR by 1 minus the reserve percentage required for Eurocurrency liabilities by Federal Reserve Regulation D (0 at the time of the debt issue). The applicable interest rate margins required based on DEK's current credit ratings are shown in *Exhibit III-2.*[123]

Exhibit IV-2
Interest Rate Margins
as of December 31, 2011

Ratings	Applicable Margin
≥A2/A	87.5
A3/A-	100.0
Baa1/BBB+	125.0
Baa2/BBB	137.5
Baa3/BBB-	162.5
≤Ba1/BB+	187.5

Source: Information Response 54

Although issued in conjunction with the issuance of $67,025,000 DEI's Indiana Finance Authority Environmental Refunding Revenue Bonds, governing documentation was clear that each borrower (DEK and DEI) were to be held "severally liable, not jointly or jointly and several liable," with respect to the payments due on the bonds issued for the borrower's benefit, and also responsible for its own bond issuance transaction costs. Joint costs attributable to the transaction as a whole would be allocated to each borrower in proportion to the relative principal of each borrower's bonds.[124]

To determine if DEK risk is embedded in long-term debt obligations of its affiliates, Schumaker & Company auditors reviewed the documentation from a sample of Duke Energy's long-term debt instruments, including capital leases, as of the end of 2011. This sample included 46% of DEK's outstanding long-term debt and 13% of Duke Energy's long-term debt. Additionally documentation representing 96% of the long-term debt issued by Duke Energy in 2011 were included in the sample. This review was made to determine if the debt documentation contained clauses or covenants that could possibly expose DEI to financial damage or risk. The long-term debt instruments reviewed are shown in *Exhibit IV-3*.[125]

Exhibit IV-3
Sampled Long-term Debt Instruments
as of December 31, 2011

No.	Entity	Description	Balance ($000)	Rate	Type	Settlement	Maturity
1	Duke Energy Kentucky	Other	$8,515	4.770%	Fixed	07/31/07	07/31/27
2	Duke Energy Kentucky	Other Pollution Control Bond - LC	$50,000	0.080%	Floating	12/03/08	08/01/27
3	Duke Energy Kentucky	Unsecured	$100,000	4.650%	Fixed	09/17/09	10/01/19
	Total DEK		**$158,515**				
4	Duke Energy Business Services	Capital Lease	$39,889	7.750%	Fixed	03/01/11	12/20/46
5	Duke Energy Carolinas	Capital Lease - Dan River	$7,100	14.714%	Fixed	12/19/11	11/30/41
6	Duke Energy Carolinas	First Mortgage Bond Taxable	$500,000	3.900%	Fixed	05/19/11	06/15/21
7	Duke Energy Carolinas	First Mortgage Bond Taxable	$350,000	1.750%	Fixed	12/08/11	12/15/16
8	Duke Energy Carolinas	First Mortgage Bond Taxable	$650,000	4.250%	Fixed	12/08/11	12/15/41
9	Duke Energy Corporation	Unsecured	$500,000	3.550%	Fixed	08/25/11	09/16/21
10	Duke Energy Corporation	Unsecured	$500,000	2.150%	Fixed	11/17/11	11/15/16
	TOTAL Duke Energy		**$2,705,504**				

Source: Information Response 39 and Duke Energy Website - Long-Term Debt Detail

Credit Ratings

DEK's credit ratings for its senior unsecured debt at the end of 2011 was listed as Stable, with ratings of A- by Standard & Poor's (S&P) and Baa1 by Moody's Investor Service (Moody's). These ratings were comparable or better than its Duke Energy affiliates.[126] The ratings for DEK were based on the consolidated credit profile of Duke Energy and reflected the consolidated credit profiles of all of the Duke Energy domestic operating subsidiaries – Duke Energy Carolinas, Duke Energy Ohio, Duke Energy Indiana, and DEK – and contributions from Duke Energy's Latin American operations and existing and planned renewable generation investments. The credit rating agencies did not anticipate that the planned merger with Progress Energy would adversely affect DEK's ratings and thought that this action could strengthen DEK's credit profile over time.[127]

However, in July 2012, S&P lowered DEK's credit rating from A- to BBB+, along with the corporate credit rating for Duke Energy and the other utility affiliates. Additionally, the senior unsecured debt of Duke Energy was lowered from BBB+ to BBB. The outlook for DEK and all of the affected affiliates was changed from CreditWatch with negative implications to negative, reflecting the potential for the credit ratings to drop lower in the next 12 to 18 months if Duke Energy does not satisfactorily deal with the increased regulatory risk in North Carolina and Florida and effectively manage the integration of Progress Energy with Duke Energy. S&P stated that regulatory risk has been heightened in North Carolina and Florida due to the abrupt leadership changes at Duke Energy following the merger with Progress Energy. S&P indicated that the decision to change CEOs was a "foregone conclusion" and had significantly weakened Duke Energy's consolidated "excellent" business risk profile. Further, S&P described the circumstances that transpired as being deficient governance processes combined with a lack of transparency of key information. S&P has stated that it will continue to monitor how the Duke Energy Board of Directors and executive management resolve or navigate the issues that have been revealed, but thought that the parties involved had a significant "journey ahead to restore their credibility with regulators and in the marketplace."[128] As of the end of September 2012, Moody's has not changed DEK's credit rating, leaving it Baa1, with a Stable outlook.[129]

Ratings for all of the Duke Energy operating companies at December 31, 2011, and September 30, 2012 (after the credit downgrade) are shown in *Exhibit IV-4*.[130]

Exhibit IV-4
Duke Energy Credit Ratings
as of December 31, 2011 and September 30, 2012

ENTITY	December 31, 2011		September 30, 2012	
	S & P	MOODY'S	S & P	MOODY'S
Duke Energy Kentucky				
Outlook	Stable	Stable	Negative	Stable
Senior Unsecured	A-	Baa1	BBB+	Baa1
Duke Energy Corporation				
Outlook	Stable	Stable	Negative	Stable
Corp. Credit Rating/Issuer Rating	A-	Baa2	BBB+	Baa2
Senior Unsecured	BBB+	Baa2	BBB	Baa2
Commercial Paper	A-2	P-2	A-2	P-2
Duke Energy Carolinas				
Outlook	Stable	Stable	Negative	Stable
Senior Secured Debt	A	A1	A	A1
Senior Unsecured	A-	A3	BBB+	A3
Duke Energy Indiana				
Outlook	Stable	Stable	Negative	Stable
Senior Secured Debt	A	A2	A	A2
Senior Unsecured	A-	Baa1	BBB+	Baa1
Duke Energy Ohio				
Outlook	Stable	Stable	Negative	Stable
Senior Secured Debt	A	A2	A	A2
Senior Unsecured	A-	Baa1	BBB+	Baa1

Source: Information Response 24 and Duke Energy Website

Short-Term Debt

DEK's short-term debt requirements are handled by Duke Energy's Treasury Department, which is part of Duke Energy Business Services (DEBS), the Duke Energy service company. Short-term cash requirements for the Duke Energy companies are fulfilled through use of a consolidated money pool arrangement whereby short-term funds are lent and borrowed amongst participating Duke Energy affiliated companies. Outside source of funds for the money pool is a Duke Energy commercial paper program. An additional source of funds is from a consolidated credit facility.[131]

Money Pool

The current Utility Money Pool Agreement was entered into on November 1, 2008, amending an earlier agreement to reflect the merger of Duke Energy Shared Services into DEBS. This agreement authorizes DEK and a number of its affiliates to participate in a short-term borrowing and lending arrangement to better manage cash and working capital requirements. Under this arrangement, those companies with surplus short-term funds provide short-term loans to affiliates participating under this arrangement.

Short-term funds borrowed may be from either internal or external sources. The participants in the Duke Energy Money Pool Agreement are shown in *Exhibit IV-5.*[132]

Exhibit IV-5
Duke Energy Money Pool Participants
as of December 31, 2011

Participant	State of Registration	Description	Money Pool Rights	
			Lend	Borrow
Duke Energy Corporation	Delaware	Parent Company	X	
Cinergy Corporation	Delaware	Holding company Subsidiary of Duke Energy Corporation	X	
Duke Energy Carolinas	North Carolina	Public utility Subsidiary of Duke Energy Corporation	X	X
Duke Energy Indiana	Indiana	Public utility Subsidiary of Cinergy Corporation	X	X
Duke Energy Ohio	Ohio	Public utility Subsidiary of Cinergy Corporation	X	X
Duke Energy Kentucky	Kentucky	Public utility Subsidiary of Duke Energy of Ohio	X	X
Miami Power Corporation	Indiana	Public utility Subsidiary of Duke Energy of Ohio	X	X
KO Transmission Company	Kentucky	Non-utility Subsidiary of Duke Energy of Ohio	X	X
Duke Energy Business Services	Delaware	Service company (Administrative Agent of the Money Pool) Subsidiary of Duke Energy Corporate Services	X	X

Source: Information Responses 1 and 23

Each Duke entity in the Money Pool can contribute funds to the Money Pool. Each participant determines daily, "on the basis of cash flow projections and other relevant factors" and at each party's "sole discretion," the amount of excess cash that they have available to contribute to the Money Pool. The decision to lend funds to the Money Pool is made by each participant's Chief Financial Officer or Treasurer, or their designee. Any participant may withdraw their funds from the Money Pool at any time with notice given to DEBS as administrative agent of the Money Pool.[133]

Each of the Money Pool participants, with the exception of Duke Energy and Cinergy, are authorized to borrow cash on a short-term basis from the Money Pool, subject to the availability of funds. The decision to borrow from the Money Pool is at the sole discretion of the borrowing company and can only be made by the borrower's chief financial officer or treasurer, or their designee. No participant can be required to borrow from the Money Pool if it is determined that money can be borrowed at a lower

cost from other sources (such as banks or the sale of its own commercial paper), and the participant is authorized to effect such a borrowing.[134]

The source of funds available in the Money Pool to be borrowed comes from the following sources:[135]

- Surplus funds – from the treasuries of Money Pool participants. Borrowers borrow their funds from each Money Pool lending party in proportion to the amount loaned to the Money Pool by each lender in relation to the total amount loaned at any one time.
- External funds – proceeds from borrowings by participants, including the sale of commercial paper by Duke Energy, Cinergy, Duke Energy Carolinas, Duke Energy Indiana, Duke Energy Ohio, and Duke Energy Kentucky. These funds will be made available in a manner to result in the lowest possible cost of borrowing, consistent with individual borrowing needs and financial standing of the parties providing funds, as determined by DEBS, as administrator of the Money Pool.

Interest accrues monthly on all borrowings from the Money Pool. If the source of the borrowed funds are internal, i.e., come from other participating Money Pool companies, the interest rate is the CD yield equivalent of the 30-day Federal Reserve AA industrial commercial paper composite rate. If the composite rate is not available, then the composite rate from the previous day for which a composite rate was established is used. If the source of funds is external, the interest rate is to be equal to the lending party's cost of acquiring the funds. This can be a composite rate (weighted average of cost incurred by all parties involved) if the funds come from several lending sources. If the borrowed funds come from a combination of internal and external sources, the interest rate charged is also a composite or blended rate. In all cases, the rate charged is to be the Money Pool's cost of the money borrowed and is expected to result in a lower cost of borrowing.[136] There is no fee added to the rate charged.[137]

In 2011 DEK was a net lender to the Money Pool, lending funds to two other Money Pool participants, DEBS and DEI, throughout the year. The terms or each loan were usually one day with the exception of weekends and holidays, when terms were three to four days.[138]

DEK lent funds to DEBS every day in 2011 at rates that ranged from 0.13 % to 0.56%. Amounts lent varied from a low of $2.7 million to a high of $143.8 million. The average daily amount lent to DEBS was in excess of $77 million. Annual interest rates charged to DEBS ranged from 0.13% to 0.56%, with a weighted average interest rate of 0.1867%. The amount of interest received from DEBS in 2011 was $146,125.[139]

A summary of funds lent by DEK through the Money Pool are shown in *Exhibit IV-6.*[140]

Exhibit IV-6
Money Pool Funds Lent by DEK
as of December 31, 2011

Borrower	Period	Average Amount Lent	Weighted Average Annual Interest Rate	Interest Received
Duke Energy Business Services	Dec. 31, 2010 – Jan. 3, 2012	$77,824,976	0.1867%	$146,125
Duke Energy Indiana	July 7, 2011 – Jan. 3, 2012	$1,125,628	0.3484%	$1,225
Totals/Weighted Average		**$78,950,604**	**0.1874%**	**$147,350**

Source: Information Response 23

Commercial Paper Program

Duke Energy has only one consolidated commercial paper program, which can be used for short-term needs for all of the affiliates, including DEK.[141] Duke Energy issued $450 million of commercial paper in 2011 and loaned the proceeds through the Money Pool on a daily basis to Duke Carolinas ($300 million) and Duke Indiana ($150 million).[142]

Credit Facility

There is a $6 billion master Credit Agreement (renegotiated in November, 2011) between Duke Energy, Duke Carolinas, DEO, DEI, and DEK as borrowers and approximately 30 international banks as lenders. Approximately 49% of the funds will come from US banks, 17% will come from Asian banks, and 34% will be provided from European banks.[143] This five-year credit agreement called for $4 billion to be available at closing and the remaining $2 billion to be available after the successful merger with Progress Energy. At December 31, 2011, DEK had a maximum sublimit from this facility of $100 million. This amount was subject to be reduced based on cash draws, borrowings through the Money Pool, or use of the master credit facility to backstop the issuance of letters of credit and certain tax-exempt bonds. As of the end of 2011, DEK's available capacity from this facility was $73 million.

B. Findings & Conclusions

Finding IV-1 **DEK is not exposed to undue risk because of its long-term indebtedness or that of its affiliates.**

To determine if there was any recourse to DEK for any indebtedness incurred by an affiliate, Schumaker & Company interviewed Duke Energy personnel, whose responsibilities in 2011 included the establishment of treasury/capitalization policies for the corporation; research/execution of

corporate financing transactions (including credit facilities) for Duke Energy Corporation, Duke Energy Carolinas, Duke Energy Ohio, Duke Energy Indiana, and Duke Energy Kentucky; and interest rate risk management. This interview revealed that no indebtedness has been incurred by any affiliate of DEK that included any recourse to DEK.[144] Additionally, Schumaker & Company sampled the long-term debt instruments of DEK and its affiliates to verify that there was no indication of any recourse to DEK.

At December 31, 2011, eight Duke Energy entities had a total of 156 long-term debt instruments with a balance of $20.6 billion listed on the Duke Energy Corporation web site. Of this total 14 debt instruments with a total balance of $342.8 million had been issued by DEK. Long-term debt instruments representing 46% of DEK's year-end balance and 13% of the total Duke Energy year-end balance were selected for review.

Documentation for each of these long-term debt obligations was reviewed to identify any clauses or codicils that might affect DEK or could possibly require DEK to assume some future obligation as a result of an action or inaction by one of its affiliates. Specific sections that seemed to denote risk were reviewed in detail. For the long-term debt obligations of DEK, documentation was reviewed for the presence of any risky situations or circumstances that could adversely affect DEK's rate payers.

Throughout this review process nothing was revealed that indicated that DEK or its ratepayers were at greater risk due to its long-term debt obligations or those held by its affiliates.

Finding IV-2 **DEK is not party to any agreements that obligate it to underwrite the financial viability of any of its affiliates.**

Reviews of the Duke Energy Utility Money Pool Agreement, the $6 billion Credit Agreement, and the long-term debt obligations referred to in *Finding IV-1* revealed no obligations on the part of DEK to assist any of its affiliates. The obligations of DEK's affiliates were specific to the Duke Energy affiliate noted as the borrower and did not contain language including other Duke affiliates. There was no terminology to indicate that any affiliates of the borrower in question would be at greater risk due to the long-term debt obligation.

Finding IV-3 **DEK has not issued any security for the purpose of financing the acquisition, ownership, or operation of an affiliate.**

Securities issued by DEK consist of capital leases, first mortgage bonds, pollution control bonds, and unsecured debt. In 2011 DEK issued $50 million worth of County of Boone, Kentucky Pollution Control Refunding Bonds. The security documents for this bond issue were reviewed as well as documentation for a sample of the long-term debt representing 46% of DEK's total outstanding security issues as of December 31, 2011. There was nothing to indicate that DEK was financing the acquisition, ownership, or operation of an affiliate.

Finding IV-4 **DEK has not assumed any obligation or liability as guarantor, endorser, surety, or otherwise in respect of any security of an affiliate.**

Reviews of funding agreements and sampled debt obligation documentation did not reveal any instance in which DEK had assumed, or was to assume, obligations or liabilities as guarantor, endorser, surety, or otherwise for one of its affiliates.

Finding IV-5 **DEK has not pledged, mortgaged or otherwise used as collateral any of its assets for the benefit of an affiliate.**

A review of Duke's funding agreements (Utility Money Pool and Credit Facility), sampled debt obligation documents, and DEK's financial statements did not reveal any indication that DEK had pledged, mortgaged, or otherwise used as collateral any of its assets for the benefit of an affiliate.

Finding IV-6 **DEK has experienced a credit rating decline caused by the actions of one of its affiliates, resulting in adverse effects on its retail customers.**

DEI's credit ratings for its senior secured debt and senior unsecured debt at the end of 2011 was listed as Stable, with ratings of A/A- by Standard & Poor's (S&P) and A2/Baa1 by Moody's Investor Service (Moody's). The ratings as of March 2012 were unchanged. However, in July 2012, S&P downgraded DEK's credit rating on its senior unsecured debt to BBB+. Moody's rating remained unchanged. The effect of this downgrade will be an increase in the interest rate charged for the most recent DEK's debt issue of 25 basis points (from 100 to 125). This increase in interest rate will cost DEK an additional $125,000 annually ($50,000,000 X .0025 = $125,000).

Finding IV-7 **DEK's Money Pool lending transactions in 2011 have not caused it to incur unnecessary expense.**

DEK was in a lending position for all of 2011. DEK lent excess funds on a daily basis to DEBS and, for the last five months of the year, also to DEI. DEK was paid interest as stipulated in the Utility Money Pool Agreement equal to the CD yield equivalent of the 30-day Federal Reserve AA industrial commercial paper composite rate. In 2011 interest received by DEK for its Money Pool transactions was $147,350.

C. Recommendations

Recommendation IV-1 **DEK should isolate itself, to the extent possible, from adverse effects caused by circumstances surrounding affiliates. (Refer to Finding IV-6)**

DEK is part of the Duke Energy organization, and as such benefits from being part of a large, fiscally responsible corporate structure. However, actions of one of its affiliates (in this case the parent company) caused the credit rating agencies to downgrade DEK's credit ratings and ultimately increased

the annual cost of borrowing funds by 25 basis points. Duke Energy management indicates that the interest rate expense does not impact DEK's retail rates, if at all, until such time as it seeks an adjustment to its base rates from the Kentucky Public Service Commission and believes that it should be addressed via the rate case methodology. Nevertheless, Schumaker & Company believes that Duke Energy, as the parent company, should assume the annual excess cost, $125,000, of this adverse action, because Duke Energy's activities were the actual cause of this downgrade. Duke Energy should assume this cost for as long as the credit rating downgrade necessitates an increase in DEK annual borrowing costs.

V. Internal Controls

A. Background & Perspective

As part of the Kentucky Public Service Commission's (KPSC's) approval of the Cinergy / Union Light, Heat and Power Company (ULH&P) merger in 2006, the KPSC established 46 merger commitments, which were stated in Case No. 2005-00228. Three of these merger commitments are directly applicable to this audit. These three commitments are:

- Commitment 11 requiring proper accounting of costs.
- Commitment 12 requiring DEK maintain appropriate cost allocation procedures and commit to third party audits.
- Commitment 13 requiring DEK protect against cross subsidization.

Adhering to these three merger commitments is partially achieved through the existence and functionality of appropriate processes/procedures and effective internal controls at Duke Energy Kentucky. Internal controls are subject to specific monitoring through the Sarbanes Oxley (SOx) rules. Procedures, processes, and internal controls are monitored on an ongoing basis by the Audit Services organization. Compliance with the SOx rules and the ongoing audit function helps in maintaining the merger commitments made in Case No. 2005-00228. Both SOx and audit activities impacting DEK or affiliate transactions are discussed in the following sections.

SOx Controls

SOx controls were the ultimate result of an act passed by U.S. Congress in 2002 to protect investors from the possibility of fraudulent accounting activities by corporations. The Sarbanes-Oxley Act mandated strict reforms to improve financial disclosures from corporations and prevent accounting fraud. As a part of this Act, year-end financial reports were mandated to contain an assessment of the effectiveness of the internal controls and the company's auditing firm would be required to attest to that assessment. This has resulted in public companies registered with the SEC to list specific controls and

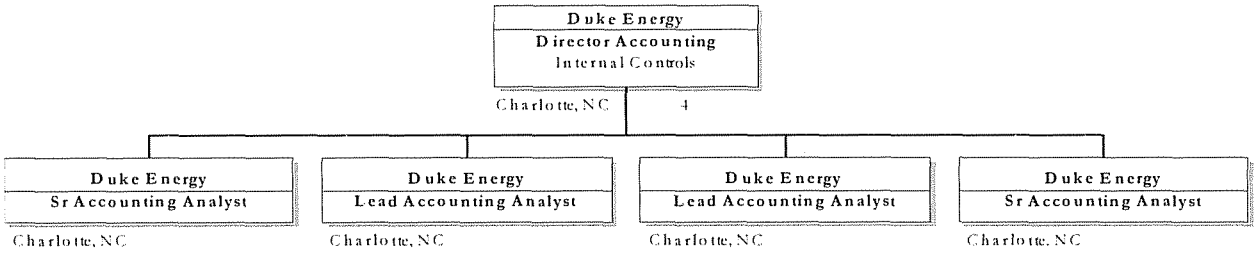
test them regularly and determine that the controls are operating effectively and as intended. These listed controls are referred to as SOx controls.

The Duke Energy organization has approximately 1,745 SOx controls, of which approximately 43 have control owners in these US Franchised Electric and Gas (FE&G) groups. Of these 43 controls, 12 were tested in 2011. The controls tested were all considered "effective"; none were "ineffective" or "undetermined." Also, SOx controls regarding accounting for services and asset transfers, such as inventory stock transfers, are generic and not specifically focused on affiliate charges, as affiliate charges do not impact Duke Energy's consolidated financial statements, and since affiliate charges are eliminated during consolidation.[145]

SOx Testing

SOx testing occurs at random and specific times during the year. When the Director of Accounting, Internal Controls, notifies the SOx representatives, each SOx representative verifies that the SOx control owners for which they are responsible are still valid. Once validity is confirmed, the SOx representative directs the control owners to begin the SOx testing. The testing results are documented ultimately in the Open Pages system with a narrative and any back up needed to confirm that the control is working. When the documentation is complete in Open Pages, the SOx representative reviews the information provided. The Internal Controls group, shown in *Exhibit V-1*, also monitors this activity and documentation on an ongoing basis.[146]

Exhibit V-1
Internal Controls Organization
as of April 2012



Source: Prior DEI Audit Interviews

Duke Energy has approximately five SOx controls dealing with affiliate relationships and charges Financial Closing and Reporting - Consolidation - Intercompany Accounting (FCRC-ICA).[147] These controls are:[148]

- Review and sign-off of various reports
- Out of balance report
- Out of balance report reviewed by business unit
- Review of reconciliation
- Controller review of elimination procedures

The USFE&G Ohio and Kentucky group has six controls, none of which address the FCRC-ICA areas; they do include the following controls:[149]

- Quarterly accrual guidelines
- Quarterly accrual and reversal spreadsheet
- Balance sheet reviews/meetings
- Roll-forward reserve schedule
- Calculation of environmental reserve
- Approval of change in environmental reserve account

Internal Audits

Four internal audits regarding affiliate transactions, cost allocations, or other Affiliate Rules aspects have been conducted in the last three years. The Corporate Audit Services group did not specifically perform any audits regarding the Kentucky/Ohio Accounting & Reporting group in 2011;[150] however, routine internal control reviews have been performed during the time period 2009 through 2011,[151] and four audits were conducted that pertained to affiliated relationships or transactions. These audits are briefly described in *Exhibit V-2*.[152]

Exhibit V-2
Internal Audits Associated with Affiliate Relationships / Transactions
2009 to 2011

Audit #	Audit Title	Date Completed
309015	Allocations Process	October 30, 2009
110007	Franchised Electric and Gas (FE&G) State Affiliate Standards Indiana and Kentucky	March 24, 2010
310006	FE&G FERC Uniform System of Accounts	June 30, 2010
111016	Non-Utility Operations Accounting Practices	July 25, 2011

Source: Information Response 15

According to the Director, Corporate Audit Services, the actions required to address each of these recommendations from these audits have been completed.

Allocations Process Audit #309015

This audit addressed the allocations process by evaluating the process and procedures for Service Company and departmental allocations across enterprise transactions for the period of July 1, 2008 to June 30, 2009. The objectives of the audit were to determine whether:[153]

- Processes and procedures were fully defined and roles and responsibilities were understood
- Allocations were consistently applied in compliance with applicable requirements
- Cost pools were clearly defined and monitored

The overall conclusion by Audit Services was that the process effectively administers allocations for the enterprise; however, the process is complex and was not fully understood by key business areas. There are opportunities for process enhancements, which impacts the roles and responsibilities of process owners at the Service Company and departmental levels. Enhancements recommended included defining and communicating roles and responsibilities, implementing consistent documentation and monitoring practices, and providing training. This moderate priority recommendation was scheduled for completion by August 31, 2010.[154] In its management response, the Duke Energy Business Services (DEBS) management accepted these recommendations and agreed to completion by the scheduled due date.[155]

Franchised Electric and Gas (FE&G) State Affiliate Standards – Indiana and Kentucky Audit # 110007

This audit addressed FE&G State Affiliate Standards- Indiana and Kentucky. The scope of this audit, which was to assess compliance with Indiana and Kentucky Affiliate Standards, focused on systems access, and controls and processes governing transactions between Duke Energy Indiana, Duke Energy Kentucky, and respective affiliates. The objectives of the audit were to determine whether processes effectively ensure:[156]

- Systems with market or confidential information had appropriate access
- Invoices for IT services were appropriately charged
- Company guidelines regarding charges covered by service requests were consistently applied
- Labor loader calculations were accurate

The conclusion of this moderate finding by Audit Services was that opportunities existed to enhance access reviews of regulated and non-regulated application data and improve the timeliness of corrections identified in the affiliate transaction review process. Also implementation would require changes to the GenWeb and MicroGads Gold system's user access and the FERC System Access Review system, whose completion was expected in 2010.[157] In its management response, DEBS management accepted these recommendations and agreed to completion by the scheduled due date.[158]

FE&G FERC Uniform System of Accounts Audit #310006

The scope of this audit was a review of Duke Energy Carolinas' compliance with the FERC Uniform System of Accounts, especially in regard to recording costs to the proper accounts, which was a

requirement of the Amended and Restated Agreement and Stipulation of Settlement related to the 2009 North Carolina rate case filings. Its objectives were to evaluate whether:[159]

- Processes, including monitoring activities, were in place to ensure compliance with the FERC Uniform System of Accounts
- Cost coding guidelines were clearly defined, communicated, and consistently applied
- Findings related to improper cost coding identified by the Public Staff were addressed

A summary of the audit report indicates that the Controller's group and Financial Planning and Analysis group were to perform monitoring processes to ensure costs are recorded to the proper accounts in compliance with the FERC Uniform System of Accounts, with the processes performed by the Controller's group designed to detect the items noted during this internal audit, but the processes had not yet been performed during 2010. Although issues were identified with labor in two accounts reviewed, there were no other issues related to the inappropriate recording of costs, including classification of recoverable and non-recoverable costs; however, the implementation of systematic controls and formal training to supplement current communications could improve the efficiency of the manual monitoring processes.[160]

In its management response, two actions were noted to address these issues, including, (a) perform enhanced training to reinforce the importance of coding costs to proper accounts and (b) work with the Finance Information Technology group to assess the feasibility of implementing key systematic controls to prevent certain account coding errors as a supplement to the current monitoring processes. All actions were to be implemented by August 31, 2010.[161]

FE&G Non-Utility Operations Accounting Practices Audit #111016

The scope of this audit was to evaluate the processes and controls governing the designation and accounting for non-utility operations, which primarily consist of residential and non-residential customer products and services, excluding accounting for products and services associated with Duke Energy One. Its objectives were to evaluate whether:[162]

- Accounting practices were in accordance with FERC guidelines and Duke Energy procedures
- Products and services were appropriately designated as non-utility operations
- Associated revenues and expenses, including allocations, were fully charged to non-utility operations
- Communication and monitoring practices were in place and operating effectively

A summary of the audit report indicates that the overall process of designating and accounting for non-regulated products and services in accordance with FERC guidelines is generally working effectively; however, opportunities exist to enhance account coding practices to ensure appropriate classification of non-utility operations, although miscoding errors noted were not considered material. One "low" item was discussed, as follows:[163]

- The product code list used to assist in identifying proper account coding includes inaccurate product code classifications and inactive products.
- Immaterial errors were noted in the recording of non-regulated and regulated operations in the general ledger.
- Certain miscodings were not identified and corrected in the review performed by Project Accounting.

In its management response, three specific actions to address these items included: (a) the Retail Customer Products and Services (RCPS) Business Management Services group is to work with Project Accounting on a routine basis to identify miscoding trends to target for reinforcement and to reinforce the proper account coding for all residential and non-residential customer products and services through the current training process, (b) the Project Accounting is to review the miscodings identified during the audit, including system generated miscodings, and record corrections for those that exceed a reasonable materiality threshold, and to document and enhance the current accounting review process to include a review for accurate classification of all nonregulated products and services for all jurisdictions, and (c) the RCPS Business Management Services is to work with Project Accounting to review and update the product code list for inaccuracies and inactive products, and also to implement a process to periodically review the product code list for accuracy. All of these actions were to be implemented by August 31, 2011.[164]

B. Findings & Conclusions

Finding V-1 **Internal audit reports regarding affiliate transactions, cost allocations, or other Affiliate Rules aspects have been addressed by DEBS staff in a timely manner.**

For each of the audits identified previously in *Exhibit V-2*, Schumaker & Company investigated if the resulting audit recommendations were addressed by DEBS staff in a timely manner. The Director of Audit Services confirmed during this audit that all corrective actions were completed and implemented by the agreed upon completion dates.

C. Recommendations

None

[1] / Information Response 1 Attachment C
[2] / Information Response 1 Attachment B
[3] / Information Response 1 Attachment B
[4] / Information Response 1 Attachment B
[5] / Information Response 3
[6] / Information Response 42

[7] / Page 41 2011 NC CAM
[8] / Information Response 45
[9] / Information Response 4
[10] / Information Response 5
[11] / Interview 7
[12] / KRS 278 2213
[13] / Interview 8
[14] / Interview 8
[15] / Interview 8
[16] / Prior DEI Audit Interviews
[17] / Prior DEI Audit Interviews
[18] / Information Response 111 from DEI Investigations
[19] / Information Response 42 from DEI Investigations
[20] / Information Response 41 from DEI Investigations
[21] / Interviews 8, 9, and 10 from DEI Investigations
[22] / Information Response 25
[23] / Information Response 25
[24] / Information Responses 27 and 28
[25] / Information Responses 27 Attachment A and 28
[26] / Information Response 27 Attachment B
[27] / Information Response 30
[28] / Interview 8
[29] / Interview 8 and Information Responses 18 and 19
[30] / Interview 8
[31] / Interview 8
[32] / Interview 8
[33] / Interview 8
[34] / Interview 8
[35] / Information Response 8
[36] / Interview 8 and Information Response 19
[37] / Interview 8 and Information Response 19
[38] / Interview 8 and Information Response 19
[39] / Information Response 16
[40] / Interview 9 and Various Information Responses as Shown in Following Paragraphs
[41] / Information Response 16 Attachment A
[42] / Information Response 16 Attachment A
[43] / Information Response 16 Attachment A
[44] / Information Response 16 Attachment A
[45] / Information Response 16 Attachment A
[46] / Information Response 16 Attachment A
[47] / Information Response 16 Attachment B
[48] / Information Response 16 Attachment B
[49] / Information Response 16 Attachment C
[50] / Information Response 16 Attachment D
[51] / Information Response 16 Attachment E
[52] / Information Response 16
[53] / Information Response 16

[54] / Information Response 16

[55] / Information Response 16

[56] / Information Response 54 from Indiana Investigation

[57] / Interview 8 and Information Response 32

[58] / Interview 8

[59] / Interview 8

[60] / Interview 8 and DEI Information Response 62 from DEI Investigations

[61] / Interview 8 and DEI Information Response 62 from DEI Investigations

[62] / KPSC Case No. 2005-00228 Order, Approved 11/29/05, Merger Agreement 12

[63] / Information Response 36

[64] / Information Response 53

[65] / Information Response 10

[66] / Information Response 10

[67] / Information Response 10

[68] / DEI Interview 4, as verified in Various DEK Interviews

[69] / DEI Interview 7 and Information Responses 1 SCH 1-10 and 140; functions 6 and 7 in IR#1-10 represents capital budgeting items , as verified in Interviews 4 and 5

[70] / DEI Information Responses 1 Attachment SCH 1 1-C and 140, as verified in Interviews 4 and 5

[71] / DEI Interview 7, as verified in Interviews 4 and 5

[72] / Interview 7

[73] / DEI Interview 7, as verified in Interviews 4 and 5

[74] / DEI Interview 7 and Information Response 141, , as verified in Interviews 4 and 5

[75] / DEI Information Response 141, as verified in Interviews 4 and 5

[76] / DEI Interview 2 and Information Response 6, as verified in Interview 1

[77] / DEI Information Response 7, as verified in Interviews 4 and 5

[78] / Information Response 46

[79] / Interview 7

[80] / Interviews 6 and 7 and Information Response 5

[81] / Interview 7 and Information Response 47

[82] / Interviews 6 and 7

[83] / Interviews 6 and 7

[84] / Interviews 6 and 7

[85] / Interview 7

[86] / Interview 7

[87] / Interview 7

[88] / Interview 7

[89] / Interview 7

[90] / Interview 6 and Information Response 48

[91] / Information Response 46

[92] / Information Response 3

[93] / Information Response 8

[94] / Interview s 4 and 5

[95] / Information Response 3

[96] / Interviews 4 and 5

[97] / Interviews 4 and 5 and Information Response 9

[98] / Interviews 4 and 5 and Information Response 9

[99] / Interviews 4 and 5

[100] / Information Response 8
[101] / Interview 8
[102] / Information Response 35
[103] / Interviews 4 and 5 and Information Response 21
[104] / Information Response 8
[105] / Information Response 8 Pages 8-9
[106] / Information Response 8 Pages 8-9
[107] / Information Response 12
[108] / Information Response 34
[109] / Information Response 13
[110] / Information Responses 3 and 6
[111] / Information Response 33
[112] / Interviews 4 and 5
[113] / Interviews 4 and 5
[114] / Information Response 33
[115] / Interviews 3, 4, and 5
[116] / Interviews 4 and 5
[117] / Interview 8
[118] / Information Response 133
[119] / Interview 4
[120] / Interview 6
[121] / Interview 6 and Information Response 52
[122] / Duke Energy Website – Long-Term Debt Details
[123] / Information Response 54
[124] / Information Response 54
[125] / Information Response 39 and Duke Energy Website – Long-Term Debt Details
[126] / Duke Energy Website – Recent Credit Rating Agency Reports
[127] / Information Response 24
[128] / Duke Energy Website – Recent Credit Rating Agency Reports
[129] / Duke Energy Website – Recent Credit Rating Agency Reports
[130] / Information Response 24 and Duke Energy Website – Recent Credit Rating Agency Reports
[131] / Interview 10
[132] / Information Responses 1 and 23
[133] / Information Response 23
[134] / Information Response 23 and Interview 10
[135] / Information Response 23
[136] / Information Response 23
[137] / Interview 10
[138] / Information Response 23
[139] / Information Response 23
[140] / Information Response 23
[141] / Interview 10
[142] / Duke Energy Website – Duke Energy Corporation Form 10-K for the year ended December 31, 2011
[143] / Interview 10
[144] / Interview 10
[145] / Interview 1
[146] / Interview 1 and Prior DEI Audit Interviews

[147] / Interview 1
[148] / Information Response 40
[149] / Interview 1 and Information Response 40
[150] / Interview 1
[151] / DEI Interview 2
[152] / Information Response 15
[153] / Information Response 15
[154] / Information Response 15
[155] / Information Response 15
[156] / Information Response 15
[157] / Information Response 15
[158] / Information Response 15
[159] / Information Response 15
[160] / Information Response 15
[161] / Information Response 15
[162] / Information Response 15
[163] / Information Response 15
[164] / Information Response 15