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BEFORE THE PUBLIC UTILITIES COMMISSION OF OHIO

In The Matter Of Duke Energy Ohio, Inc.'s Application to Change Accounting Methods	: : : :	Case No. 11-5985-GE-AAM

DUKE ENERGY OHIO, INC.'S APPLICATION TO CHANGE ACCOUNTING METHODS

1. Duke Energy Ohio, Inc., (Duke Energy Ohio or the Company) is an integrated electric light company and a natural gas company, and thus a public utility, all as defined in Sections 4905.02 and 4905.03 of the Ohio Revised Code (R.C.).

2. Through this Application, Duke Energy Ohio seeks authority, pursuant to R.C. 4905.13, to establish an account through which it will track dividends declared and paid out of Duke Energy Ohio's stated capital account.

3. Moreover, to the extent any such authority may be deemed necessary, Duke Energy Ohio seeks authority to declare and pay dividends out of Duke Energy Ohio's stated capital account subject to the limitations described in this Application.

4. As explained below, this Application addresses a second consequence of "push-down" accounting principles employed in conjunction with the 2006 merger between Duke Energy Corporation (Duke Energy) and Cinergy Corp. (Cinergy), then the ultimate corporate parent of Duke Energy Ohio. The first consequence of push-down accounting was addressed in Case No. 09-620-GE-AAM where the Public Utilities Commission of Ohio (Commission) approved Duke Energy Ohio's amended application filed on September 18, 2009, to change accounting methods and motion for expedited review (2009 Application). As provided therein, upon the Cinergy/Duke merger, Duke Energy

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determined under Securities and Exchange Commission (SEC) rules that it needed to apply push-down accounting to Duke Energy Ohio (but not to other subsidiaries of Cinergy, including Duke Energy Kentucky, Inc., (Duke Energy Kentucky) and Duke Energy Indiana, Inc. (Duke Energy Indiana). The application of push-down accounting upon Duke Energy Ohio resulted in a one-time adjustment to certain of its assets and liabilities and a resetting of Duke Energy Ohio's retained earnings to zero. (Immediately prior to the closing, Duke Energy Ohio's retained earnings account was approximately $671 million.)

5. In an order issued in response to the 2009 Application, the Commission found that Duke Energy Ohio's application to establish an account in order for it to track dividends declared and paid to its shareholders out of Duke Energy Ohio's stated capital account representative of pre-merger retained earnings was reasonable and granted the Company's application subject to the Federal Energy Regulatory Commission (the FERC) imposed limitations.[1]

6. The second consequence of push-down accounting, and the topic of this Application, derives from the fact that push-down accounting resulted in a significant amount of non-cash goodwill and other increases to net assets being pushed down from Duke Energy's balance sheet to the books of Duke Energy Ohio. Since the merger, as further discussed below, Duke Energy Ohio has analyzed goodwill for impairment under generally accepted accounting principles (GAAP), and has written down goodwill on Duke Energy

[1] In April 2006, Duke Energy Ohio, then known as The Cincinnati Gas & Electric Company, submitted a petition for declaratory order to FERC in Docket No. EL06-66, requesting that the FERC issue an order finding that the payment of dividends from its capital accounts up to the amount in its retained earnings account immediately prior to the merger does not violate Section 305(a) of the Federal Power Act (2006 Petition). The FERC granted Duke Energy Ohio's 2006 Petition provided that Duke Energy Ohio's payment of dividends from the capital accounts did not diminish the dollar value of those accounts below pre-merger retained earnings, and also provided that Duke Energy Ohio maintain a minimum equity balance equal to 30% of total capital. *See Cincinnati Gas and Electric Company, d/b/a Duke Energy Ohio, et al.*, 115 FERC ¶ 61,250 (2006) at P 13 (Petition Order).

Ohio's books. Moreover, the other increases to net assets added to Duke Energy Ohio's books as a result of push-down accounting have been amortized over time or impaired in accordance with GAAP. These non-cash amortization and impairment charges, in turn, have been written off against Duke Energy Ohio's earnings, thereby decreasing the level of GAAP earnings recorded on Duke Energy Ohio's books. With reduced GAAP earnings, Duke Energy Ohio's GAAP retained earnings were also reduced, thereby potentially bringing into question the extent to which Duke Energy Ohio can continue to make dividend payments. As stated above, Duke Energy Kentucky and Duke Energy Indiana did not apply push-down accounting, and thus there are no such potential restrictions on their ability to pay dividends.

7. As more fully discussed below, Duke Energy Ohio respectfully requests that the Commission issue an order declaring reasonable Duke Energy Ohio's request for the ability to pay dividends from equity accounts that represent adjusted retained earnings that are reflective of the amount that the Company would have had in its retained earnings account had push-down accounting not been in effect.

8. The facts that underlie and support this Application, as developed through a series of cases, are as follows:

The Merger Case

a. In Case No. 05-732-EL-MER (Merger Case), the Commission approved a merger between Duke Energy and Cinergy by Finding and Order (the Order) entered December 21, 2005.

b. In support of the merger, Duke Energy Ohio submitted the testimony of several witnesses, including those who testified that, upon information and belief, "push-down" accounting would not apply to the merged entities and thus "push-down" accounting would not adversely affect either Duke Energy Ohio's ratepayers or its shareholders.

The Post Merger Accounting Cases

c. Shortly after this Commission approved the Cinergy/Duke Energy merger, Duke Energy learned that "push-down" accounting principles would in fact be employed and thus that the merger would impact Duke Energy Ohio's balance sheet. As a result, on April 12, 2006, Duke Energy Ohio filed two cases[2] with this Commission, seeking authority to modify its accounting procedures (together with Case No. 09-620-GE-AAM, the Post-Merger Accounting Cases.)

d. The Commission approved the creation of the regulatory assets as requested by Duke Energy Ohio, relying in part upon the fact that [a]t Exhibit E of the Merger Case stipulation, it was agreed in pertinent part "that pushdown accounting would not impact ratemaking."[3]

e. As a further result of the imposition of push-down accounting principles, the level of retained earnings that existed prior to the merger became paid-in capital at the consummation of the merger.

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[2] *In the Matter of the Application of The Cincinnati Gas & Electric Company d/b/a/ Duke Energy Ohio for Authority to Modify Current Accounting Procedures in Order to Establish Regulatory Assets for its Electric Distribution Rates Relating to Push-Down Accounting Impacts Arising from the Merger of Duke Energy Corp. and Cinergy Corp.*, Case No.06-572-EL-AAM and *In the Matter of the Application of The Cincinnati Gas & Electric Company d/b/a Duke Energy Ohio for Authority to Modify Current Accounting Procedures in Order to Establish Regulatory Assets for its Gas Rates Relating to Push-Down Accounting Impacts Arising from the Merger of Duke Energy Corp. and Cinergy Corp.*, Case No. 06-573-GA-AAM.

[3] *Id.* Sept. 13, 2006 Finding and Order, p. 1, ¶2. *See also In re: Merger of Duke Energy and Cinergy Corp.*, Case No. 05-732-EL-MER; Through an Entry on Rehearing filed February 6, 2006, the Commission later reaffirmed its approval of the merger and again expressly ruled that it was not approving the stipulation:

> We determined that nothing in the substance of the stipulation would lead us to modify our findings in these proceedings. In addition, because the stipulation included certain obligations over which the Hamilton County Court of Common Pleas, rather than the Commission, would retain jurisdiction, there was no need for the Commission to approve the partial stipulation.

f. In Case No. 09-620-GE-AAM, the Commission found that Duke Energy Ohio's application to establish an account in order for it to track dividends declared and paid to its shareholders out of Duke Energy Ohio's stated capital account representative of pre-merger retained earnings is reasonable and should be granted subject to the FERC imposed limitations.

The 2011 FERC Accounting Case

9. In August 2011, Duke Energy Ohio filed a petition for a declaratory order (2011 Petition)[4] with the FERC in which it requested that the FERC issue an order finding that Duke Energy Ohio will not violate Section 305(a) of the Federal Power Act if it pays dividends from equity accounts that are reflective of the amount that it would have had in its retained earnings account had push-down accounting not been in effect (that is, Duke Energy Ohio requested permission to pay dividends from equity accounts that represented adjusted retained earnings). Adjusted retained earnings are defined for these purposes as (a) Duke Energy Ohio's retained earnings immediately before the merger ($671 million), plus (b) cumulative "adjusted net income," representing cumulative post-merger net income excluding the impacts of impairments and amortization of push-down accounting net assets and goodwill impairments, less (c) cumulative post-merger dividends.[5] The 2011 Petition was necessary to address the impact of the effects of goodwill impairment and amortization charges that occurred since the 2006 Petition that was filed at the FERC.

[4] Duke Energy Ohio, Petition for Declaratory Order, FERC Docket No. EL11-58-000, August 5, 2011.
[5] Section 305(a) provides that: it shall be unlawful for any officer or director of any public utility to receive for his own benefit, directly or indirectly, any money or thing of value in respect of the negotiation, hypothecation, or sale by any such public utility of any security issued or to be issued by such public utility, or to share in any of the proceeds thereof, or to participate in the making or paying of any dividends of such public utility from any funds properly included in capital accounts. 16 U.S.C. §825d(a)(2006).

10. In its 2011 Petition, Duke Energy Ohio discussed that the application of push-down accounting resulted in the recording of approximately $2,894 million of goodwill and other net assets, offset by an equal amount of capital. As noted in the 2011 Petition, the application of pushdown accounting was reflective of non-cash entries. Subsequent to push-down accounting, GAAP requires goodwill to be tested for impairment at a reporting unit level at least annually. When a non-cash goodwill impairment charge becomes necessary under GAAP, and when amortization or impairments of other net assets created in push-down accounting occur, GAAP requires the classification of impairment charges and amortization to be within the statement of income, thereby resulting in a reduction to retained earnings. As such, Duke Energy Ohio experienced a disconnect between its equity accounts affected by push-down accounting (*i.e.*, capital accounts) and the equity accounts affected by subsequent impairment charges and amortization of push-down accounting amounts (*i.e.*, retained earnings).

11. As outlined in Duke Energy Ohio's 2011 Petition to the FERC and illustrated in Tables 1 and 2 below, the "adjusted retained earnings" amount totaled $1,258 million as of March 31, 2011.[6]

[6] FERC Docket No. EL11-58-000, Order issued November 17, 2011.

Table 1:

GAAP retained earnings just prior to the merger	$ 671
Post merger adjusted net income [1]	1,567
Post-merger dividends	(980)
Retained earnings as of March 31, 2011, adjusted to remove the affects of push-down accounting ("adjusted retained earnings")	$1,258

[1] Represents cumulative post-merger reported net income excluding the impact of impairments and amortization of push-down accounting net assets and goodwill impairments ("adjusted net income").

Table 2:

GAAP retained earnings as of March 31, 2011	$ (773)
Add: Stated capital account, reflecting pre-merger retained earnings less dividends applied to the account	340
Add: Net after-tax loss attributable to impairments and amortization of push-down accounting net assets (including goodwill impairments)	1,691
Retained earnings as of March 31, 2011, adjusted to remove the affects of push-down accounting ("adjusted retained earnings")	$1,258

12. On November 17, 2011, the FERC issued an order (2011 Petition Order) granting Duke Energy Ohio's petition, finding that it is appropriate for Duke Energy Ohio to remove the effects of push down accounting in determining the funds available to pay dividends.[7] The FERC noted in its order that Duke Energy Ohio clearly identified the source from which dividends would be paid and that the dividends paid will not exceed Duke Energy Ohio's adjusted retained earnings.[8] As such, Duke Energy Ohio will not be paying more dividends than it would have been able to pay absent the push down accounting associated with the merger. In the 2011 Petition Order, the FERC authorized Duke Energy Ohio to pay dividends from its equity accounts in the future, provided the Company will cease paying dividends out of capital accounts if its "adjusted retained earnings" fall to $0 or if such payments result in adjusted equity falling below 30 percent of its total capital.[9]

<u>Duke Energy Ohio's Post-Merger Rate Cases</u>

13. On June 25, 2008, Duke Energy Ohio filed notice of its intent to file an application for an increase in rates for electric distribution service within its service territory, asking that the test year begin January 1, 2008, and that the date certain be March 31, 2008. Its notice was docketed to open Case No. 08-709-EL-AIR, *et al.* (the Rate Case). Duke Energy Ohio subsequently filed its application with the Commission on July 25, 2008.

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[7] *Duke Energy Ohio, Inc.*, 137 FERC ¶ 61,137 (2011).

[8] *Id.* at P 17,

[9] *Id.* The Company is not requesting that the Commission establish a minimum equity ratio in this proceeding. The Company is merely requesting the Commission permit its shareholders to remain in the same position held prior to the merger and as already approved by the FERC.

14. On July 8, 2009, this Commission issued its Opinion and Order in the Rate Case, approving a stipulation filed on March 31, 2009. Among the stipulated terms, the Parties agreed that:

> For purposes of any riders that require a rate of return, the calculation of the rate of return shall be made on the basis of Duke's actual adjusted[10] capital structure and a return on equity of 10.63% (which is the midpoint of staff's recommended return on equity.)[11]

15. Duke Energy Ohio's actual adjusted capital structure as of the March 31, 2008 date certain selected for its Rate Case consisted of a debt ratio of 41.72% and an equity ratio of 58.28%. Duke Energy Ohio's overall return on rate base, using the capital structure and return on equity approved for riders, equaled 8.89%.

16. More recent retail rate cases of Duke Energy Ohio have also appropriately used the adjusted capital structure to properly exclude from equity all purchase accounting pushed-down to Duke Energy Ohio's balance sheet.[12]

17. Accordingly, this proposed treatment is consistent with the equity capital structure used in retail rate cases, and therefore will have no negative effects whatsoever upon rate payers.

18. Duke Energy Ohio herein seeks authority to declare and pay dividends to its shareholders out of Duke Energy Ohio's equity accounts (including capital and retained earnings accounts) that represent adjusted retained earnings. As noted above, "Adjusted retained earnings" is defined for these purposes as (a) Duke Energy Ohio's retained earnings

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[10] The adjustments removed from the equation the impact of purchase accounting, consistent with Duke Energy Ohio's merger commitment, as well as the value certain former Duke Energy North America assets contributed to Duke Energy Ohio.

[11] *In re: In the Matter of the Application of Duke Energy Ohio, Inc. for an Increase in Electric Distribution Rates*, Case No. 08-709-EL-AIR, *et.al.* Opinion and Order at 8 (July 8, 2009).

[12] Id. *See e.g.* Direct Testimony of Peggy A. Laub at 5 (August 8, 2008).

immediately before the merger ($671 million), plus (b) cumulative "adjusted net income," representing cumulative post-merger net income excluding the impacts of impairments and amortization of push-down accounting net assets and goodwill impairments, less (c) cumulative post-merger dividends. The effect of such an order would be approval to pay dividends from equity accounts for the amount of retained earnings that would have existed had purchase accounting not been pushed-down to Duke Energy Ohio, subject to the limitations approved by the FERC in its 2011 Petition Order as described within this Application.

19. Duke Energy Ohio also seeks authority, pursuant to R.C. 4905.13, to establish an account through which it will track dividends declared and paid to its shareholders out of Duke Energy Ohio's adjusted equity accounts. Prior to the closing of the merger, Duke Energy Ohio's retained earnings were recorded in Account 216 – *Unappropriated Retained Earnings*. At the time of the merger closing, those amounts were transferred to Account 211 – *Miscellaneous Paid-in Capital*. In order to track the extent to which dividends could be made from this account, the amount of retained earnings transferred into Account 211 were recorded in a separate sub-account of Account 211. Duke Energy Ohio proposes to also track in a separate sub-account of Account 211 the amount of post-merger net losses attributable to impairments and amortization of push-down accounting net assets, including goodwill, attributable to the merger. In the future, as dividends are made that are in excess of the amounts in Duke Energy Ohio's GAAP retained earnings accounts at the time of the dividend, the applicable sub-accounts in Account 211 will be reduced correspondingly, until the applicable sub-accounts are reduced to zero. At that time, Duke Energy Ohio will stop making dividends from its capital accounts.

20. Approval of this Application is consistent with all commitments assumed by Duke Energy Ohio in both the Merger Case and the Post-Merger Accounting Cases. Further, approval of this Application will have no negative effects whatsoever upon rate-payers.

21. Approval of this Application will in no way be inconsistent with the authority granted Duke Energy Ohio in the FERC's 2011 Petition Order. As discussed, the FERC authorized Duke Energy Ohio to pay dividends from its equity accounts in the future, provided the Company will cease paying dividends out of capital accounts if its "adjusted retained earnings" fall to $0. Also, Duke Energy Ohio is required by the FERC 2011 Petition Order to cease paying dividends out of capital accounts if its adjusted equity balance falls below 30 percent of its total capital ("adjusted equity" represents reported equity, adjusted to remove the effects of push-down of purchase accounting).

22. Duke Energy Ohio files its quarterly and annual financial information as part of its SEC Form 10-Q and Form 10-K, which provide a continuing view of the Company's financial position during the year. Through the balance sheet included in the SEC documents and certain adjustments as filed in support of its rate applications, the Commission will be able to monitor the level of Duke Energy Ohio's adjusted capital structure on a quarterly basis. Furthermore, on an annual basis Duke Energy Ohio will disclose in a note to its FERC Form 1 financial statements the balances of adjusted retained earnings and adjusted equity.

23. The transaction will not have any adverse impact on ratepayers and is consistent with the commitments made in Case No. 05-732-EL-MER, *et al.,* to hold both ratepayers and shareholders harmless from purchase accounting principles. In order to allow it to be in a position to properly plan the timing of its 2012 and 2013 dividends, Duke Energy Ohio

respectfully requests that the Commission issue its order in this proceeding by no later than March 1, 2012.

WHEREFORE, Duke Energy Ohio, Inc. respectfully requests that the Commission GRANT it the accounting authority described within this Application.

Respectfully submitted,

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