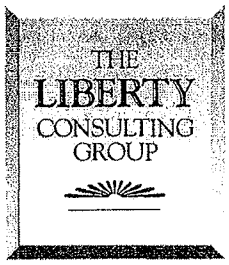
Final Report
Audit of Duke Energy Indiana's Affiliate Standards Compliance

Public Version
(CONFIDENTIAL MATERIALS ARE REDACTED)

Presented to:

The
The Indiana Utility Regulatory Commission

By:



65 Main Street
Quentin, Pennsylvania 17083

(717) 270-4500 (voice)
(717) 270-0555 (facsimile)
admin@LibertyConsultingGroup.com (e-mail)

March 15, 2009

Table of Contents

I. Introduction 1

II. Standard C: Accounting for Affiliate Transactions 3

- A. Background 3
- B. Findings 3
  - 1. Affiliate Transactions 3
  - 2. Asset Transfers 6
- C. Conclusions 10
- D. Recommendations 12

III. Standard D: Financial Obligations 13

- A. Background 13
- B. Findings 13
  - 1. Long-Term Debt Agreements 13
  - 2. Revolving Credit Agreements 16
  - 3. Guarantees and Credit Support 18
  - 4. Receivables Securitization Agreement 19
  - 5. Intercompany Long-Term Debt and Loans 19
  - 6. Credit Rating Effects 20
  - 7. Pension and OPEB Liabilities 21
- C. Conclusions 21
- D. Recommendations 23

IV. Standard E: Untariffed, Non-utility Services 24

- A. Background 24
- B. Findings 24
- C. Conclusions 26
- D. Recommendations 26

V. Standard F: Goods or Services from Non-utility Affiliates 27

- A. Background 27
- B. Findings 27
- C. Conclusions 27
- D. Recommendations 27

VI. Standard G: Wholesale and Generation Operations 28

- A. Background 28

B. Findings....28
1. Physical Separation....28
2. Tracking Employee Movement....28
C. Conclusions....29
D. Recommandations....29
VII. Standard H: Common Property Ownership....30
A. Background....30
B. Findings....30
C. Conclusions....30
D. Recommendations....30
VIII. Standard I: Sharing Information with Marketers....31
A. Background....31
B. Findings....31
1. Customer Information....31
2. Market Information....32
C. Conclusions....35
D. Recommendations....35
IX. Standard J: Name and Logo Sharing....36
A. Background....36
B. Findings....36
C. Conclusions....37
D. Recommendations....37
X. Standard K: Tying....38
A. Background....38
B. Findings....38
C. Conclusions....38
D. Recommendations....38
XI. Standards L and M: Space, Equipment, System Sharing....39
A. Background....39
B. Findings....39
1. Office Space....39
2. Information Systems....39
C. Conclusions....41
D. Recommendations....42

XII. Standard N: Limits on Corporate Support to Affiliates....43
A. Background....43
B. Findings....43
C. Conclusions....43
D. Recommendations....43
XIII. Standard O: Availability to Third Parties....44
A. Background....44
B. Findings....44
C. Conclusions....44
D. Recommendations....44
XIV. Standard P: Documentation....45
A. Background....45
B. Findings....45
C. Conclusions....46
D. Recommendations....46
XV. Standards Q, R, and S: Contact Designations....47
A. Background....47
B. Findings....47
C. Conclusions....47
D. Recommendations....47
XVI. Standard T: Affiliate Contract Filings....48
A. Background....48
B. Findings....48
C. Conclusions....48
D. Recommendations....48
XVII. Standard V: Audits and Controls....49
A. Background....49
B. Findings....49
C. Conclusions....49
D. Recommendations....49
XVIII. Standard Z: Approval of Power Purchases....51
A. Background....51
B. Findings....51

C. Conclusions 51

D. Recommendations 51

XIX. Informational Filings 52

A. Background 52

B. Findings 52

1. Annual Informational Filings 52
2. Additional Annual Informational Filings 52
3. Special Informational Filing 53

C. Conclusions 53

D. Recommendations 53

I. Introduction

On March 15, 2006, the Indiana Utility Regulatory Commission (IURC) issued its Order in Cause No. 42873 regarding the merger of Duke Energy Corporation (Duke Energy) and Cinergy Corp. (Cinergy), the parent of PSI Energy, Inc. (PSI), later renamed Duke Energy Indiana (DE-Indiana). As part of its approval, the IURC adopted Affiliate Standards for DE-Indiana and merger conditions requiring DE-Indiana to prevent cross-subsidization in its transactions with affiliates. The Order also approved five merger-related agreements:

- Service Company Utility Service Agreement
- Operating Companies Service Agreement
- Operating Company/Nonutility Companies Service Agreement
- Utility Money Pool Agreement
- Agreement for Filing Consolidated Income Tax Returns and for Allocation of Consolidated Income Tax Liabilities and Benefits.

As a condition of approval, the IURC required a series of four biannual audits of DE-Indiana's compliance with its Affiliate Standards.

Duke Energy issued a request for proposal (RFP) on behalf of the parties of interest in the merger proceedings, which include the Indiana Office of Utility Consumer Counselor (OUCC) and IURC Staff. The RFP solicited proposals for, among other things:

- An audit of DE-Indiana's affiliate transactions between January 1, 2007 and December 31, 2007 undertaken pursuant to the merger-related agreements, and with all conditions regarding affiliate transactions in the Order, including the propriety of transfer pricing of goods and services between or among DE-Indiana and its affiliates.
- A one-time audit of the reasonableness of the five merger-related agreements entered into by DE-Indiana, as well as a review of the cost allocation factors in the Service Company Utility Service Agreement.
- An audit of DE-Indiana's compliance with its Affiliate Standards, including the training and controls that it has in place to prevent cross-subsidization.

The Liberty Consulting Group (Liberty) was chosen to perform these audits. A companion report addresses the first two items. This report sets forth the findings, conclusions, and recommendations resulting from Liberty's audit of the fourth item; *i.e.*, DE-Indiana's compliance with the Affiliate Standards.

The Order in IURC Cause No. 42873 sets forth 26 standards. Six of them do not establish auditable standards. Liberty examined compliance with the remaining 20 standards. The following are the six standards excluded from specific audit activities:

Standard A	General principles and guidelines for affiliate financial policies and transactions
Standard B	Establishes the right of access to affiliate books records, filings, officers, and employees
Standard U	Makes standards' violations subject to Commission enforcement powers and penalties
Standard W	Addresses the effect of repeal of the Public Utility Holding Company Act of 2005
Standard X	Assures no impairment of current service and holding company structure

Standard Y Permits goods and services exchanges per approved agreements and FERC requirements

Liberty also examined various reports that the Standards require DE-Indiana to file.

II. Standard C: Accounting for Affiliate Transactions

A. Background

Standard C of the Affiliate Standards states that DE-Indiana should record all transactions with affiliates in accordance with Generally Accepted Accounting Principles (GAAP), and that it should maintain sufficient records to allow for an audit of those transactions. Standard C also states that goods and services provided by DE-Indiana to a non-utility affiliate, or by a non-utility affiliate to DE-Indiana, should be accounted for in accordance with current Securities and Exchange Commission (SEC) or Federal Energy Regulatory Commission (FERC) requirements as applicable.

Standard C also applies to the transfer of assets between DE-Indiana and non-utility affiliates. The Standard states that asset transfers from DE-Indiana to a non-utility affiliate or from a non-utility affiliate to DE-Indiana should be accounted for in accordance with current SEC or FERC requirements, as applicable. Because asset transfers had not been addressed in any other context, Liberty conducted a more extensive review of them.

B. Findings

1. Affiliate Transactions

Duke Energy processes all affiliate transactions in accordance with GAAP. DE-Indiana and its affiliates use a chart of accounts that is consistent with the FERC Uniform System of Accounts. The first three numbers of each DE-Indiana general ledger account represent the corresponding FERC account. The stated purpose of the corporation's written policy regarding accounting for affiliate transactions is to ensure the timely, accurate, and consistent reconciliation, recording, and elimination of inter-company transactions in accordance with GAAP. The policy includes general policy statements providing that: (a) all inter-company transactions will be recorded, (b) inter-company account balances will be reconciled, and (c) discrepancies will be resolved. The corporate documentation sets out roles and responsibilities in general terms. The documentation provides general descriptions of the methods of recording inter-company transactions, settlement, and reconciliation, but does not provide significant detail on how to process individual affiliate transactions.

Liberty sought to determine whether all inter-company transactions flow through inter-company payables and receivables accounts. Liberty asked for reports showing audit-period affiliate transactions between DE-Indiana and its non-Service Company affiliates. Accounting personnel provided inter-company charge data that reflect charges flowing through inter-company payables and receivables accounts (*i.e.*, FERC accounts 145, 146, 233, and 234). The data originated from the labor, accounts payable, inventory, and vehicle charge systems. It covered more than affiliate transactions, however. For example, invoices for Midwest utilities are paid from the same location; therefore, some portion of the accounts payable charges reflect pass-throughs of costs related to goods or services provided from some other party, rather than directly from the utility making the

charges. The data also included system-generated and manual journal entries made for various purposes, such as recording interest income and expenses related to the Money Pool Agreement.

Accounting personnel indicated that all transactions under the Operating Companies Service Agreement (Operating Agreement) and the Operating Company/Non-utility Companies Service Agreement (Non-utility Agreement) will be reflected as inter-company charges through the payables and receivables accounts. The same is true for charges under the Service Company Utility Service Agreement. Accounting personnel indicated that the company also uses inter-company sub-ledger accounts to record certain charges and payments between companies (*e.g.*, inter-company transmission revenues in account 456 and transmission services in account 565). DE-Indiana's reporting requirements to the IURC as it relates to affiliate transactions are governed by Section III of the Affiliate Standards. No other available reports clearly defined the entire population of affiliate transactions; therefore, Liberty could not reconcile account balances to the general ledger.

The Standard requires pricing of transactions between DE-Indiana and non-utility affiliates to be consistent with applicable SEC or FERC requirements. The SEC "at cost" standard applies to charges from a centralized service company, and is therefore not the relevant standard for these transactions.

FERC Order 667 states that with respect to non-power goods and services transactions between holding company affiliates other than traditional, centralized service companies: (a) sales from a public utility to a non-regulated, affiliated special purpose company should be priced no less than cost, *i.e.*, the higher of cost or market, and (b) the non-regulated affiliated company may not sell to the public utility at a price above market price, *i.e.*, the lower of cost or market. FERC Order 707 reiterated the affiliate pricing policy, and clarified that it applied to all non-utility affiliates, not just those with market-based rate authority. FERC Order 697 outlined pricing policies for transactions between a utility and a non-regulated power sales affiliate; Order 707 clarified that the pricing policies apply to all non-utility affiliates.

Duke Energy does not consider these FERC pricing rules applicable to DE-Indiana transactions with its non-utility affiliates under DE-Indiana's Utility/Non-Utility Service Agreement. It relies upon the FERC Order 707 statement that, to the extent that different pricing was in effect for any agreement entered into before the effective date of Order 707 (March 31, 2008), that pricing should remain in effect. DE-Indiana believes that the pricing under the Non-Utility Agreement is not governed by the FERC Order, because that agreement came prior to March 31, 2008.

Most of the transactions involving DE-Indiana and its non-utility affiliates during the audit period occurred under the Non-utility Agreement. The terms of this agreement specifies that parties provide goods and services at fully embedded cost.

The following tables summarize the amounts (as reflected in the inter-company charge data provided by the company) that relate to transactions involving DE-Indiana and a non-utility affiliate. The first shows DE-Indiana as the service provider or originator of the charges, and the second shows DE-Indiana as the client or receiver of the charges.

Inter-company Charges from DE-Indiana to Non-utility Affiliates

Client	Loaded Labor	Materials	Outside Services, Contract Labor/Mat.	Employee Expenses/ Vehicle	Payables	Journal Entries	Total
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Inter-company Charges from Non-utility Affiliates to DE-Indiana

Client	Loaded Labor	Materials	Outside Services, Contract Labor/Mat.	Employee Expenses/ Vehicle	Payables	Journal Entries/ Other	Total
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

DE-Indiana also provided $6.0 million of goods and services to Duke Energy Ohio (DE-Ohio). A portion of that work related to the non-regulated generation segment of the affiliate. Similarly, DE-Ohio provided $3.5 million of goods and services to DE-Indiana, some portion of which may have been performed by the non-regulated portion of DE-Ohio. Pricing for all of the work was at fully embedded cost, which is consistent with the terms of both the Operating Agreement and Non-Utility Agreement.

Liberty's transaction testing in the audit of merger-related agreements and affiliate transactions examined a considerable number of transactions. The company was able to provide satisfactory support and documentation for the charges. Overall, Liberty determined that DE-Indiana and its non-utility affiliates priced the transactions

appropriately. There was one exception, in that non-utility affiliates did not add overhead to labor charges, and thus priced its service at less than fully distributed cost.

DE-Indiana is also a party to other agreements with affiliates other than those discussed above:

- Master Transmission Tower Licensing Agreement with DukeNet Communications
- Master Land Lease and Development Right Agreement with Cinergy Communication
- Purchase and Sale Agreement with Cinergy Receivables Company
- Joint Transmission System Planning and Operating Agreement with DE-Ohio and Duke Energy Shared Services (DESS)
- Water Supply Agreement with CinCap Madison
- Railcar Use Agreement with DE-Ohio and DESS
- Interconnection Agreement with DE-Ohio and DESS
- Spare Transformer Sharing Agreement with both affiliated and unaffiliated parties.

DE-Indiana filed these agreements with the IURC as part of its Annual Filing. These agreements were either approved by FERC or the IURC. Those involving non-regulated affiliates were all executed prior to March 31, 2008, and the FERC policy also does not apply.

2. Asset Transfers

Liberty examined the method by which the company records assets transfers and the method by which it prices such transfers. As with other types of affiliate transactions, Duke Energy records these asset transfers in accordance with GAAP, thus satisfying the necessary requirements.

FERC policy for transactions not covered by existing agreements is that: (a) public utilities should provide non-power goods and services to a non-regulated affiliate at the higher of cost or market, and (b) non-regulated affiliates should provide goods and services to a public utility at no higher than market. DE-Indiana indicated that it follows these FERC "asymmetrical pricing" rules for plant asset transfers. It also does so for transfers of inventory items. Therefore, for the purposes of this Standard, DE-Indiana considers assets to include both capitalized plant assets as well as inventory stock items.

a. Capital Assets

Duke Energy uses the Power Plant capital-asset accounting system to maintain the capital fixed asset records of its regulated utilities, including DE-Indiana. The system also maintains records for certain of its non-utility companies, including KO Transmission and several Duke Energy Generation Services (DEGS) affiliates. The Power Plant system records asset additions and retirements, and records transfers between companies, provided that each entity's assets are maintained in the system. Power Plant uses a variety

of general ledger accounts to record transactions. They include: Plant in Service (101), Plant Held for Future Use (105), and Construction Work in Progress (107).

Liberty asked for a list of all asset transfers involving DE-Indiana during 2007. The company's response indicated few transfers of plant assets involving utility affiliates and none between DE-Indiana and its non-utility affiliates. However, a Liberty review of the inter-company charge data identified an April 2007 manual journal entry for $260,752. Accounting personnel determined this entry was issued to cover an asset transfer. DE-Indiana had transferred a transformer to Cinergy Solutions Utility, which in turn sold the transformer to General Electric for an emergency situation. DE-Indiana sold the transformer in 2007; however, accounting did not unitize and retire the asset in Power Plant until 2008. Therefore the transaction was not reflected in the plant asset retirements in DE-Indiana's 2007 FERC Form 1 Report. The transformer was of pre-1999 vintage and had been part of plant in service, but was taken out of service and reclassified as a capital spare in 2006.

Liberty sought to determine why the transaction was not identified as an asset transfer in the documentation provided. Company personnel responded that they had generated from Power Plant a list of asset transfers, and that all items involved transfers between regulated utilities. The Cinergy Utility Solutions transaction did not appear on the list because it was not recorded in Power Plant. Because the non-regulated affiliate's assets are not maintained in the system, accounting had to record this transfer using manual journal entries.

Duke Energy uses a work order to initiate the retirement of an asset and the calculation of salvage value. DE-Indiana sought to transfer the asset at the higher of cost or market. The asset transfer occurred before FERC Order 707 made clear that asymmetrical pricing rules apply to non-utility affiliates such as Cinergy Utility Solutions. DE-Indiana chose to apply the FERC pricing rules to this transaction although it stated that it was not required to do so. Accounting personnel provided the work order related to the transformer, which indicated that the asset had an original value of $205,000, but was fully depreciated; therefore, its cost was essentially zero. To determine a market value, DE-Indiana used the April 2007 price of a new transformer ($197,900), and then applied its normal material and overhead loaders to yield the price of $260,752. DE-Indiana used this "market value" as the salvage value of the transformer.

Liberty sought to determine whether there were any other asset transfers involving DE-Indiana and a non-regulated affiliate during the audit period. For test purposes Liberty focused specifically on the "Retirement Work In Progress" account (108410). Company personnel indicated that an entry in this account is used to start the process of retirement and calculation of salvage value for a transferred asset. Accounting generated a report on this account, which did list the transformer addressed above. Liberty and the company examined several items on the report, but none involved asset transfers to a non-regulated affiliate.

Liberty also selected from the inter-company transaction data several DE-Indiana to Cinergy Utility Solutions charges that were recorded using manual journal entries and that involved similar account codes as the transformer transfer. Liberty asked accounting personnel to examine these charges; none related to asset transfers. Liberty thereupon concluded that there were likely to have been no other plant asset transfers from DE-Indiana to a non-regulated affiliate during the audit period. There were no journal entries in the inter-company charge data to indicate that any assets had been transferred from a non-regulated affiliate to DE-Indiana.

The transformer transfer discussed above was included as part of the charges from DE-Indiana for work it performed for Cinergy Energy Solutions under a formal Service Request, the stated purpose of which was to provide labor, vehicles, and equipment to perform miscellaneous substation maintenance. Such asset transfers are not covered by the Non-utility Agreement. Article I, Section 1.1(c) explicitly states: "For the avoidance of doubt, affiliate transactions involving sales or other transfers of assets, goods, energy commodities (including electricity, natural gas, coal and other combustible fuels) or thermal energy products are outside the scope of this Agreement." The company acknowledged that transfers should not be handled in this way, and that it should have a process in place to cover transfers of assets between regulated and non-regulated entities.

b. Inventory

Duke Energy uses the Passport inventory accounting system for managing the inventory of its utilities as well as the inventory of several non-utility affiliates. Inventory items are part of working stock and are not capitalized. Duke Energy handles accounting for the sale of inventory items in two different ways: as "transfers" or as "issuances." The former method applies when one warehouse charges an item to another warehouse, which then in turn charges it to the end user. The latter occurs when the issuing warehouse directly charges an item to the appropriate end user.

The Passport system records all transfers and issuances of inventory items among utilities. The company uses the following FERC accounts in inventory issuances and transfers: 145 (notes receivable from associated companies), 146 (accounts receivable from associated companies), 233 (notes payable to associated companies), and 234 (accounts payable to associated companies). Inventory is recorded in 154 balance sheet accounts. The Passport system applies stopgaps that block transactions between certain entities. A utility cannot directly charge inventory to non-regulated affiliates unless the system is specifically programmed to allow it.

Passport handles the accounting for inventory sales in two different ways. In the case of an inventory item transfer, the system creates a credit to an inventory account and debit to a receivables account on the seller's side, and a debit to an inventory account and credit to a payables account on the buyer's side. Such transfers do not appear in inter-company charge data, because the accounting entries do not cross company lines. In the case of inventory issuances, Passport creates a credit to an inventory account on the seller's side and a debit to an account (such as an expense account) on the buyer's side. BDMS later automatically creates the debit and credit to the appropriate inter-company payables and

receivables accounts. Such inventory sales show up in the inter-company charge data, because accounting entries do cross company lines.

Passport automatically charges the average unit price for an item that is issued or transferred. However, DE-Indiana applies the FERC asymmetrical pricing rules to sales of inventory items between DE-Indiana and a non-utility affiliate or a non-regulated utility affiliate, which FERC now categorizes as a market power sales affiliate. An adjustment in price is required in some cases. Duke Energy assumes that the average unit price for distribution and transmission related items reflects market price because the items have a high turnover rate. Company supply-chain personnel conduct a "replacement value" analysis for certain generation-related inventory items, because the turnover rate for some of these items is much lower. The accounting group issues journal entries throughout the year to record price adjustments to and from DE-Indiana as needed to comply with the FERC rules.

Inventory charges to DE-Indiana from non-utility affiliates during the audit period were nominal, amounting to less than $200. Nearly all inter-company charges for transmission and distribution (T&D) related inventory items from DE-Indiana to non-regulated affiliates were made to Duke Energy One, which is a subsidiary company of Cinergy Utility Solutions. A formal Service Request had been set up for DE-Indiana to handle the receipt of certain inventory items on behalf of Duke Energy One, and the company had programmed Passport to allow direct charges from DE-Indiana to the non-utility affiliate in this case.

DE-Indiana charges to Duke Energy One totaled approximately $300,000 in 2007. They consisted of separate charges for stock materials and for shipping, freight, and handling (SF&H). Charges for stock materials originate from the Passport system. BDMS applies an SF&H loader, currently eight percent to most, but not all inventory items. Liberty selected from inter-company charge data several inventory charges to Duke Energy One, and worked with company personnel to trace the original stock charges and average unit prices in Passport. This review found that the accounting process worked correctly for the selected transactions. Liberty also worked with company personnel to substantiate that all charges to non-regulated affiliates for inventory sales during the audit period flowed through Passport, and that none were made via journal entry.

The company provided a list of generation-related inventory items sold as transfers and as issuances, all of which involved the non-regulated generation portion of DE-Ohio. Language in the Ohio Administrative Code effectively separates DE-Ohio generation from T&D. In 2007, transfers from DE-Indiana to the non-regulated generation portion of DE-Ohio totaled approximately $8,800. Transfers from the non-regulated portion of DE-Ohio to DE-Indiana totaled approximately $5,300. The company indicated that all of these items were of the type covered by blanket purchasing agreements; therefore, the replacement price was essentially the same as the average unit price. Accounting thus was not required to make any offsetting journal entries for differences in cost versus market price.

The six total 2007 issuances by the non-regulated portion of DE-Ohio to DE-Indiana covered ten items, and totaled approximately $6,500. The 24 total 2007 issuances by DE-Indiana to non-regulated DE-Ohio covered 123 items, and totaled approximately $28,000. Based on the replacement value analysis, accounting made an adjustment of $751.87 to decrease the total price paid to DE-Ohio for issuances to DE-Indiana and an adjustment of $14,381.72 to increase the total price paid to DE-Indiana for issuances to DE-Ohio non-regulated generation. Liberty reviewed with accounting personnel the journal entries it made to adjust these prices for 2007.

Liberty discussed with company personnel the derivation of the transfer price for two of the issuance transactions. Due to the relatively small dollar value of the items, Liberty did not require paper documentation. The first transaction involved a sale to DE-Indiana of two inventory items totaling $1,513. The replacement cost of the items in the market was $1,578; *i.e.*, higher than the average unit price or DE-Ohio's cost. The company indicated that it chose not to charge DE-Indiana $1,513 as the lower of the affiliate's cost or the market price. Instead it took a conservative approach to determining transfer prices, in order to flow the benefit to the utility affiliate. Warehouse and purchasing personnel explained that it estimated the cost for DE-Indiana to repair two of its own existing items at $840. The "cost" from DE-Indiana's perspective was therefore lower than the $1,513 transfer price; DE-Indiana later received a credit for the difference. The second transaction involved an item originally issued by DE-Indiana for $16,134. This item had a replacement value of $26,155. DE-Indiana later received an additional $10,021 for the difference in value. Company personnel explained that this item had been made by DE-Indiana's internal machine shop at a cost of $16,134. The shop is now out of business; therefore, DE-Indiana would have had to purchase a similar item from the market for approximately $26,155 if it wanted to replace it. DE-Indiana appropriately charged DE-Ohio the higher of cost or market in this case.

C. Conclusions

1. DE-Indiana records affiliate transactions and maintains sufficient records in accordance with Standard C.

DE-Indiana processes affiliate transactions in accordance with GAAP. During the course of its audit of DE-Indiana affiliate transactions, Liberty found that the company was able to provide sufficient records of affiliate transactions and adequate support for charges.

2. Pricing of affiliate transactions between DE-Indiana and non-utility affiliates were consistent with Standard C with a minor exception.

Unless otherwise specified, pricing of transactions between a regulated utility and its non-utility affiliates are subject to the FERC policy. DE-Indiana is a party to the Non-utility Agreement, which covers certain transactions with non-utility affiliates; it is also a party to other agreements with non-utility affiliates, such as a transmission tower agreement with DukeNet. DE-Indiana entered into these agreements before the effective date of FERC Order 707. Pricing of these transactions is therefore not governed by the FERC pricing policy but rather by the terms of the agreements.

The Non-Utility Agreement specifies that transactions occur at fully distributed cost. Liberty's transaction testing in the audit of merger-related agreements and affiliate transactions examined a considerable number of transactions. Liberty determined that transactions with non-utility affiliates were priced appropriately. There was one exception; a non-utility affiliate did not add overhead to labor charges of $2,366, and thus priced its service to DE-Indiana at less than fully distributed cost.

3. DE-Indiana transferred one capital asset to a non-regulated affiliate in 2007, and priced the transaction consistently with the requirements of Standard C.

DE-Indiana transferred a transformer to Cinergy Utility Solutions, which subsequently sold it to General Electric. Liberty's review gave reason to find that it was likely the only plant asset transfer involving DE-Indiana and a non-utility affiliate during the audit period. DE-Indiana chose to apply FERC asymmetrical pricing rules to this transaction even though it occurred before FERC Order 707 made clear that non-utility affiliates such as Cinergy Utility Solutions are subject to these pricing rules. Under the FERC policy, DE-Indiana could have used the market value of transformers of similar vintage to calculate the appropriate transfer price. There is not a liquid market for such equipment. Using the value of a new replacement transformer at $260,752 was thus a utility-generous approach under the circumstances. In this case, DE-Indiana sold a fully depreciated vintage transformer for the price of a new one.

4. Duke Energy does not have a formal policy or process for asset transfers between utility and non-utility affiliates. *(Recommendation #1)*

Duke Energy can record asset transfers in its capital asset accounting system, Power Plant, only if the system maintains the documentation of the assets of the buying and selling affiliates. Otherwise, accounting must record the transfer through the use of journal entries. While the Power Plant system has reporting and query capabilities that facilitate management of transfers, there is no process in place to manage transfers via journal entry. Similarly, the company has no formal written policy regarding transfers between utility and non-utility affiliates. The company began during 2008 to take steps to address this deficiency. It developed a procedure for generation-related inventory transfers between DE-Indiana, Duke Energy Kentucky (DE-Kentucky), and Duke Energy Ohio (DE-Ohio).

Liberty found that Duke Energy recorded the asset transfer properly from a general-ledger account perspective. However, DE-Indiana treated the transformer transfer as part of its work under a formal Service Request, even though asset transfers are outside the scope of the Non-utility Agreement. The company agreed with Liberty that the transfer should not have been handled in this way.

5. Inventory item sales between DE-Indiana and non-utility affiliates are made at prices consistent with the requirements of Standard C.

Duke Energy applies the FERC asymmetrical pricing rules to sales of inventory items between DE-Indiana and non-regulated affiliates. Duke Energy uses the average unit price as the transfer price for T&D-related items and for generation-related items purchased under a blanket-type agreement. It believes that the average unit price is

equivalent to market price, because these items have a relatively high turnover rate. For non-blanket order generation-related inventory items that have a slower turnover rate, supply-chain personnel conduct a "replacement value" analysis to determine market price. For this latter group, the accounting group issues journal entries at year-end to adjust for the difference between the average unit price as charged by Passport and the appropriate transfer price of the item as needed to comply with the FERC rules. Liberty found this approach to be reasonable.

D. Recommendations

1. **Develop a formal policy for transfers of capital assets between a utility and non-utility affiliate, and develop a process to record and manage such transfers.** *(Conclusion #4)*

Duke Energy should be able to identify all transfers of capital fixed assets regardless of whether they were recorded in the Power Plant system. Duke Energy should develop a formal policy and process for transfers of assets between regulated and non-regulated entities. Such transfers are subject to different pricing criteria; *i.e.*, Standard C of the Affiliate Standards and the FERC asymmetrical pricing rules, than those among utilities. Additional procedures are needed to: (a) record the reason for the transfer and document management approvals, (b) record the steps used to calculate transfer price, and (c) describe the proper ways in which to record the transaction in the accounting system. The process should provide a means for management to track and report such transfers.

III. Standard D: Financial Obligations

A. Background

Standard D addresses the potential damaging effects on the utility of affiliate financing, credit agreements, credit support and other financial obligations. Standard D requires DE-Indiana to comply with the following restrictions:

> *Company shall not allow a Non-Utility Affiliate to obtain credit under any arrangement that would permit a creditor, upon default of the Non-Utility Affiliate, to have recourse to Company's assets. The financial arrangements of Company's Affiliates are subject to the following restrictions unless otherwise approved by the Commission:*
>
> 1. *Any indebtedness incurred by a Non-Utility Affiliate shall be without recourse to Company.*
> 2. *Company shall not enter into any agreements under terms of which Company is obligated to commit funds in order to maintain the financial viability of a Non-Utility Affiliate.*
> 3. *Company shall not make any investment in a Non-utility Affiliate under circumstances in which the Company would be liable for the debts and/or liabilities of the Non-Utility Affiliate incurred as a result of the acts or omissions of a Non-Utility Affiliate.*
> 4. *Company shall not issue any security for the purpose of financing the acquisition, ownership or operation of a Non-Utility Affiliate.*
> 5. *Company shall not assume any obligation or liability as guarantor, endorser, surety, or otherwise in respect of any security of a Non-Utility Affiliate.*
> 6. *Company shall not pledge, mortgage, or otherwise use as collateral any assets of Company for the benefit of a Non-Utility Affiliate.*
> 7. *Company shall hold harmless the retail customers of Company from any adverse effects of company credit rating declines caused by the actions of Non-Utility Affiliates.*

The potential for negative financial effects to DE-Indiana could be related to agreements or obligations entered into by the utility, by its owner or holding company (Cinergy or Duke Energy), or by a variety of non-utility affiliates. Liberty has identified and reviewed a wide range of financial agreements, documents and financial statements to determine DE-Indiana's compliance with Standard D.

B. Findings

1. Long-Term Debt Agreements

a. Duke Energy Debt Outstanding at December 31, 2007

Duke Energy and Cinergy have sold or divested numerous non-utility businesses, both prior to and subsequent to the merger. One of the largest and most recent of the divestitures was the spin-off of the Spectra Energy gas businesses as of January 1, 2007.

The merged Duke Energy and Cinergy organizations have allowed for a significant reduction in holding company and non-utility debt, as sales and divestitures have produced a holding company much more focused on the utility business. However, some holding company and international and domestic non-utility debt remained outstanding at December 31, 2007.

The company provided a detail of Duke Energy debt at December 31, 2007. Close to 200 long-term debt instruments remained outstanding within the corporate family of companies. This debt had a total principal amount of $11.024 billion outstanding. Duke Energy Carolinas (DE-Carolinas) and the former Cinergy utility businesses accounted for most of these debt instruments and outstanding obligations. The next table summarizes consolidated debt outstanding (in millions of dollars) by business category.

Duke Energy Long-Term Debt at December 31, 2007

Debt Source	Principal
A) Utility Long-term Debt	
DE-Carolinas	$5,393
DE-Indiana	$2,145
DE-Ohio	$1,936
Total Utility Long-Term Debt	***$9,474***
B) Holding Company and Non-Utility Long-Term Debt	
Cinergy Corp.	$ 202
Duke Energy International	$930
Duke Energy Generation Services	$ 177
Cinergy Global Resources (including ATTIKI)	$ 239
Duke Energy Royal and Duke Net Communications	$ 2
Non-Utility Long-Term Debt	***$1,550***
Duke Energy Total Long-Term Debt	***$11,024***

b. Review of Financing Agreement Sample

Liberty selected a sample of fifteen debt agreements to review, in order to evaluate DE-Indiana's compliance with certain of the requirements of Standard D. Liberty examined whether the agreements contained clauses or covenants that expose DE-Indiana to financial damage from a variety of sources: the holding companies of Cinergy and Duke Energy, non-utility affiliates, commitments in DE-Indiana's own financing documents, and from affiliated utility companies.

The selection included debt agreements for the long-term debt financings of the Cinergy holding company and for five of the largest debt financings of the remaining non-utility international operations of both Duke Energy and Cinergy. These non-utility debt agreements represented over 75 percent of the Duke Energy non-utility long-term debt outstanding at December 31, 2007. Liberty also reviewed the debt financing agreements for five different types of DE-Indiana debt financings and two debt financing agreements from other Cinergy utilities, DE-Ohio and DE-Kentucky. The following table lists the agreements that Liberty reviewed. The balances shown are in millions of dollars.

Duke Energy Debt Agreement Sample

Entity	Security Type	Rate	Maturity	Balance
Cinergy Corp.	Unsecured, Fixed Rate	6.53%	2/16/2008	$200
Cinergy Global Res	Unsecured, Guaranteed, Insured, Fixed Rate	6.20%	11/3/2008	$150
CinCap V	Guaranteed Notes, Fixed Rate	9.23%	11/5/2016	$100
CGP Greece Holdings	Secured Floating Rate	5.91%	11/20/2016	$ 88
Guatemala Y Compania	Secured, Guaranteed Floating Rate	8.33%	10/15/2015	$ 75
Paranapanema Project	Unsecured, Guaranteed Floating Rate	17.51%	5/15/2013	$570
DE-Indiana	Capital Lease w/ Mortgage	5.12%	12/31/2016	$ 9
DE-Indiana	Unsecured, Floating Rate Pollution Control	3.80%	12/1/2038	$ 40
DE-Indiana	Floating Rate Pollution Control	4.50%	12/1/2039	$ 77
DE-Indiana	First Mortgage Bonds	8.00%	7/15/2009	$125
DE-Indiana	Unsecured Notes, Fixed Rate	5.00%	9/15/2013	$400
DE-Ohio	Capital Lease, Secured	5.00%	12/30/2015	$ 6
DE-Ohio	Unsecured Notes, Fixed Rate	5.70%	9/15/2012	$500
DE-Kentucky	Capital Lease, Secured	8.60%	9/30/2020	$ 2
DE-Kentucky	Unsecured notes, Fixed Rate	6.20%	3/10/2036	$ 65

Liberty reviewed the following aspects of holding company and non-utility financing agreements associated with debt issuances to determine whether they contained any terms and conditions having a potential for causing financial impact to DE-Indiana:

- Identity of the issuing entity
- Type of project or business financed
- Use of funds
- Security or collateral provided and any potential links to DE-Indiana or utility assets
- Defined recourse(s) for the repayment of debt
- The specific non-recourse structure of a project financing
- Guarantees or credit support provided from outside sources, usually from the holding company entities
- Representations and warranties of the issuing entity
- Negative covenants affecting the issuer, such as the types of occurrences and triggers that can cause a default
- Default remedies for the instrument; *i.e.*, actions that occur in the case of default
- Whether the financing could in any way be tied to DE-Indiana
- "Structural subordination."

Structural subordination addresses the concept that each legal corporate entity between DE-Indiana and a non-utility entity with debt financing provides an additional layer of legal protection from external creditors. In other words, even if a default were to occur on an affiliate international project, creditors must first go through several layers of legal entities to present claims on the holding companies. Without any direct ties to a utility entity in the financing agreements, any claims by such non-utility creditors would also have to go through the holding company to the utilities. That chain of events is considered unlikely.

Liberty's review of the non-utility financings revealed that:

- Cinergy guaranteed the debt issuances of Cinergy Global Resources and CinCap V
- Duke Energy guaranteed the financing of Guatemala Y Compania, SA
- Duke Energy International guaranteed the Paranapanema Project financing.

Liberty reviewed the five DE-Indiana financings to determine:

- The security interest in the financings, such as an indenture or mortgage related to first mortgage bonds
- Whether the financing was unsecured and relied on the cash flow of the utility business in general.

Liberty found that, in one of those financings, DE-Indiana obtained bond insurance on the issuance when the cost of the insurance was less than the related interest rate benefit.

Liberty's review of the DE-Indiana financings (as well as those of DE-Ohio and DE-Kentucky) also sought to identify any cross-default provisions between the utilities or with the holding company. Liberty also examined the financing agreements for liens permitted, collateral, pledges or sales of utility assets. The DE-Ohio and DE-Kentucky agreements were reviewed for any mention of DE-Indiana or its assets or cash flow, as well as any cross-default provisions and specific remedies for defaults. Liberty's experience with utility financings within the same holding company has been that they are self-contained and do not threaten sister utilities; nevertheless Liberty reviewed these clauses to ensure that such separation is evident among the former Cinergy utilities.

c. Confirmations of DE-Indiana Compliance

Liberty also discussed each of the fifteen financings with Duke Energy financial managers. The Duke Energy managers represented that none of the agreements of the Duke Energy or Cinergy non-utility affiliates allow creditors recourse against DE-Indiana. They also represented that none of the DE-Indiana financing agreements and none of the other Duke Energy utility subsidiary agreements allow creditors recourse against DE-Indiana. The company also provided written confirmations of compliance with the requirements of Standard D in response to several data requests issued by Liberty.

d. 2007 DE-Indiana Debt Issuances

The Duke Energy financial managers reported that the only new debt issuances by DE-Indiana in 2007 were two capital leases, signed on December 31, 2007, having total principal amounts of about $7.1 million, and bearing interest rates of 5.12 percent.

2. Revolving Credit Agreements

Revolving credit agreements are key financing documents; they represent the commitments of a syndicate of lenders to provide working capital funding to utility holding companies and their utility subsidiaries. Cinergy and its utility subsidiaries were parties to a five-year revolving credit agreement syndicated by JP Morgan Chase Bank

and dated September 9, 2005. This revolving credit agreement was terminated in June 2007, and replaced by a larger revolving credit agreement covering the liquidity needs of Duke Energy, DE-Carolinas, DE-Ohio, DE-Indiana and DE-Kentucky. The new revolving credit facility for the merged companies was subsequently amended to increase its size in March 2008.

The Cinergy revolving credit agreement and the Duke Energy revolving credit agreement that replaced it were used primarily as back-up lines of credit to provide liquidity support for commercial paper programs. The holding company commercial paper programs were used to fund the utility money pool for the Cinergy companies and for the new Duke Energy utility money pool established after the merger. The money pool and other commercial paper borrowing of the holding companies are dependent upon the revolving lines of credit to access the capital markets. Consequently, their commitments and covenants are the key financial requirements that would be enforced in the event of financial difficulties with the named borrowers.

a. Cinergy 2005 Revolving Credit Agreement

The 2005 Cinergy revolving credit agreement was for a maximum amount of $2.0 billion of total borrowing capacity for Cinergy, DE-Ohio, DE-Indiana and DE-Kentucky as the named borrowers. The size of the facility was reduced to $1.5 billion in November 2006 after the sale of the Cinergy trading operations reduced the holding company's credit needs. DE-Ohio and DE-Indiana had borrowing sub-limits of $500 million, and DE-Kentucky had a sub-limit of $65 million under this agreement. The borrowers had the option of loans at the prime rate, or at London Interbank Rate (LIBOR) plus a spread based on their credit rating. The utilities could borrow at LIBOR plus 0.35 percent, while Cinergy, which had a lower rating, could borrow at the higher rate of LIBOR plus 0.425 percent. The most important restrictive financial covenants of this credit facility were that each borrower was required to maintain:

- A ratio of total debt to total capitalization of no more than 0.65 to 1 to borrow funds
- A minimum net worth to borrow funds (the DE-Indiana minimum net worth was set at $900 million).

b. Duke Energy 2007 Revolving Credit Agreement

The Duke Energy holding company and its utilities entered into a $2.65 billion revolving line of credit with a syndication of banks led by JP Morgan Chase. The borrowers under the facility credit agreement are Duke Energy, DE-Carolinas, DE-Ohio, DE-Indiana and DE-Kentucky. The credit facility replaced the $1.5 billion Cinergy facility described above, a $400 million Duke Energy facility, and DE-Carolinas credit facilities totaling $750 million. The new 2007 credit facility provided an equal amount of total borrowing capacity as the facilities that it replaced. DE-Indiana's borrowing sub-limit was increased to $400 million under this agreement.

The credit facility serves primarily as back-up liquidity support for two commercial paper programs: the DE-Carolinas $700 million program, and Duke Energy's $1.5 billion

program. The holding company commercial paper program is used to fund the utility money pool and the liquidity needs of the Duke Energy holding company, including acquisitions.

The key restrictive covenants of the credit facility are a debt-to-capitalization maximum for borrowing of 65 percent that is identical to that of the Cinergy facility that it replaced. There is no net worth requirement for borrowing in the Duke Energy facility agreement.

3. Guarantees and Credit Support

Guarantees and credit support provided by a utility to a non-utility affiliate, to its holding company parent, or to third party entities unrelated to the utility business have the potential to cause financial harm to the utility. The merger Settlement Agreement states that "DE-Indiana will not guarantee the credit of any of its affiliates unless specifically approved by the Commission." DE-Indiana does not provide guarantees or credit support of this type. Liberty confirmed the absence of them through a review of DE-Indiana's audited financial statements at December 31, 2007.

The provision of guarantees and credit support by a utility's holding company parent could adversely affect the utility subsidiary in the event that a number of conditions should occur simultaneously. It is rare, but conceivable, that all of these risk factors could be present in a utility holding company that has non-utility businesses substantially larger in scope than the utility businesses. These simultaneously occurring factors are:

- Guarantees to risky non-utility businesses that may fail
- Dollar amounts of such "at risk" guarantees that are much greater than the equity capital of the holding company
- Utility structural accessibility to the creditors of beneficiaries being guaranteed by the holding company.

The following table summarizes in millions of dollars the guarantees provided by the Duke Energy companies at December 31, 2007.

Duke Energy Guarantees at December 31, 2007

Guarantor	Entity	Amounts	No.
[redacted]	[redacted]	[redacted]	[redacted]

Liberty also reviewed a detailed listing of individual guarantees, and discussed the specifics of a sample of the largest guarantees with Duke Energy finance employees. The largest of the guarantees is from Duke Energy to the Carolinas utility, which was put in place only because the holding company was the original named issuer of Duke Energy's utility debt prior to the utility's restructuring after the merger with Cinergy. Duke Energy employees also noted that Cinergy is no longer providing guarantees, and that the existing Cinergy guarantees are from pre-merger operations.

4. Receivables Securitization Agreement

The Receivables Securitization Agreement governs a program that finances the accounts receivable of the three Cinergy utility subsidiaries, including DE-Indiana. The financing arrangement is specified in a Purchase and Sale Agreement dated March 31, 2002 between Cinergy Receivables Company LLC and the three utilities.

Cinergy Receivables buys all receivables booked by the utilities each business day in a true sale transaction. The transactions remove the receivables from utility current asset accounts. The receivables are purchased at a discount that compensates Cinergy Receivables for financing costs, bad debt allowances, collection fees, and administrative costs, but excludes any profit factor. Using the receivables as collateral, Cinergy Receivables borrows from two financing entities, Windmill Funding Corp. (ABN AMRO) and Jupiter Securitization Corp. (JP Morgan Bank One) that represent the two banks who split the $400 million program. Windmill and Jupiter issue commercial paper to fund the loans to Cinergy Receivables.

Cinergy Receivables does not have recourse to the utility originators for bad debts or other problems with collections. Rather, the discount rate adjusts as historical bad debts and days outstanding are included in a constantly-adjusting purchase price discount. The financing entities receive a security interest in the receivables from Cinergy Receivables to provide collateral backing for the loans.

5. Intercompany Long-Term Debt and Loans

Inter-company loans are specifically restricted by the IURC Merger Order and the merger Settlement Agreement.

a. Intercompany Long-Term Debt

The following restriction is included in the Merger Order:

> *DE-Indiana shall acquire its long-term debt funds through the financial markets, and shall neither borrow from nor lend to, on a long-term basis, Duke Energy Corporation or any of its other Affiliates.*

Liberty did not find any long-term loans between DE-Indiana and the parent or affiliates.

b. Intercompany Loans

The Settlement Agreement included the following merger commitment:

> *DE-Indiana will not loan any funds (or advance any credit or indemnity) to New Duke Energy, Cinergy, or other affiliates without the prior authorization of the Commission, except as provided for in the Utility Money Pool Agreement.*

On an annual basis, Duke Energy treasury management attests that DE-Indiana has complied with both of these restrictions stated in a. and b. above. However, the company also advises that intercompany receivables and payables are settled between companies on a periodic basis, with no interest charged. Liberty considers the receivables and payables to be a type of informal loan if they were not settled monthly before the close of the accounting books. This opinion is consistent with Liberty's conclusions and recommendations regarding service agreement settlements in the accompanying "Merger –Related Agreements" report.

The utility money pool provides a separate and structured mechanism and operating procedures for actual beneficial short-term loans between the Duke Energy utility companies; the utility money pool is also examined in the "Merger-Related Agreements" report.

6. Credit Rating Effects

DE-Indiana's corporate credit rating is currently A- from Standard and Poor's (S&P), and its issuer rating is Baa1 from Moody's. The Moody's rating has remained at the same level since 1995; however, Standard and Poor's increased the ratings of DE-Indiana and all of the merged Duke Energy entities by two rating categories on May 21, 2007. S&P increased the DE-Indiana corporate rating from BBB to A- at that time.

S&P rates the DE-Indiana business risk profile as "Excellent," and its financial risk as "Intermediate." These S&P levels are the same for all of the Duke Energy entities that have a rating. S&P uses a consolidated method to determine the ratings on individual entities in a holding company; the rating of each is based on that of the holding company. The Standard and Poor's method recognizes that a holding company and affiliates affect the risk of a utility subsidiary:

> *The ratings on Duke Energy Indiana, Inc. reflect the consolidated credit profile of its parent Duke Energy Corp. The ratings on Duke Energy reflect the company's focus on primarily regulated utility operations. Material capital spending needs somewhat offset these positive attributes.*
> ...

The improvement in S&P credit ratings at all of the Duke Energy companies reflects the significantly reduced business risk at both Duke Energy and Cinergy from the levels of three to five years ago. In the past few years, Duke Energy has:

- Reduced its ownership in Duke Energy Field Services from 70 percent to 50 percent
- Sold most of Duke Energy North America's merchant generation portfolio
- Sold the Duke Energy trading book
- Spun off the Spectra gas businesses
- Sold 51 percent of the Crescent real estate holdings.

Each of these actions contributed to a significant reduction in the risk of the Duke Energy holding company due to the removal of non-utility business and financial risk. DE-Indiana has benefited from reduced affiliate risks through both Cinergy's reduced non-utility activities and the merger's linkage to the new, lower-risk Duke Energy holding company family.

7. Pension and OPEB Liabilities

Liberty's 2007 audit of the implementation of North Carolina merger conditions examined the pension and benefit programs of both legacy Duke and Cinergy companies. That report observed that care must be taken to ensure that combining operations and resources does not produce a merging of existing liabilities that should remain separate, and that the merged company should be diligent in keeping these liabilities and responsibilities with their originating source.

The North Carolina report found that Duke Energy has traditionally kept its numerous pension and other post-employment benefits (OPEB) plans intact and separate so that each utility and other affiliate entities would be responsible for its own plan. The accounting and funding for both Duke and Cinergy legacy pension and OPEB plans had been kept separate, and the company managed them as a group. In the future, the company will either keep its various plans intact and separate or, in the event that plans are combined, the company will ensure to the extent necessary that it can separately account for the liabilities of each of the historical plans.

The company provided updated annual actuarial reports on all of the Duke and Cinergy pension and OPEB plans as of January 1, 2007 in this audit. These reports and discussions with Duke Energy personnel confirmed that separate plans have been retained for DE-Indiana.

C. Conclusions

1. The Cinergy non-utility affiliate and holding company indebtedness do not have recourse to DE-Indiana.

Liberty's review of a sample of the financing agreements of Cinergy and non-utility affiliates did not reveal any agreements with recourse to DE-Indiana. The documents also did not reveal any cross-defaults, liens, or claims to assets or cash flow that could harm DE-Indiana.

2. **The company specifically attests to compliance with the Standard D restrictions regarding non-utility financial impacts on DE-Indiana.**

The company has attested to compliance with these requirements both verbally and in response to specific data requests. Liberty's review and evaluation of its sample of the non-utility financing agreements, DE-Indiana financing agreements, and DE-Ohio and DE-Kentucky financing agreements did not uncover any reason to question the company's compliance.

3. **The revolving credit agreements of Cinergy and Duke Energy and the Receivables Securitization Agreement have not negatively affected DE-Indiana.**

The 2005 revolving credit agreement of Cinergy, which was in effect until June 2007, and that of Duke Energy thereafter provide working capital liquidity support to DE-Indiana. The agreements did not contain any clauses that would negatively affect DE-Indiana.

4. **DE-Indiana has not issued guarantees and is not negatively affected by the guarantees of its parent holding companies.**

DE-Indiana has not issued guarantees that support activities outside of its regulated utility business. Duke Energy and Cinergy have granted a significant level of guarantees. Liberty did not find them to pose a significant risk to DE-Indiana. Any Duke Energy international guarantees are structurally far removed from DE-Indiana within the holding company structure; therefore, they have not posed material risk. The Cinergy guarantees are of a reasonable level for the size of the holding company. Moreover, the guarantees are not identified by credit rating agencies as posing risk to the former Cinergy utilities.

5. **DE-Indiana has complied with IURC restrictions on intercompany loans, with one minor exception.**

DE-Indiana has attested to compliance with intercompany loan restrictions included in the Merger Order and the merger Settlement Agreement. However, the company does not settle all of its intercompany balances on a monthly basis, as required by the intercompany service agreements. Conclusions and recommendations regarding Liberty's findings on this topic are included in the accompanying "Merger-Related Agreements" report.

6. **DE-Indiana's credit ratings have improved due to a reduction in exposure to non-utility affiliate risks.**

The reduction in non-utility risk to DE-Indiana and the other Duke Energy utilities is due to a concerted effort by Duke Energy, and to a lesser extent by Cinergy, to reduce exposure to these riskier businesses over the past few years. DE-Indiana's exposure to non-utility risks is considered minimal by the rating agencies as of 2007, which is consistent with Liberty's view.

7. **DE-Indiana is not affected by the pension and OPEB plans of other Duke Energy companies due to the maintenance of individual plans.**

D. Recommendations

Liberty has no recommendations regarding Standard D.

IV. Standard E: Untariffed, Non-utility Services

A. Background

Standard E states that any untariffed non-utility services provided by DE-Indiana or by the Service Company should be itemized in accounting entries pursuant to a written contract or agreement. DE-Indiana and the Service Company must maintain and make available for inspection copies of all accounting entries and each contract or arrangement that relate to the provision of such untariffed, non-utility services.

The Service Company provides traditional and utility-related services to DE-Indiana under the Service Company Utility Service Agreement (Service Company Agreement). DE-Indiana and its utility affiliates provide utility-related goods and services to each other under the Operating Agreement. DE-Indiana provides similar utility-related goods and services to its non-utility affiliates subject to the Non-utility Agreement. Non-utility affiliates provide DE-Indiana with small amounts of goods and services under the same agreement. DE-Indiana is also a party to agreements with affiliates other than these three merger-related agreements. These other agreements include the Master Transmission Tower Licensing Agreement with DukeNet Communications and the Interconnection Agreement with DE-Ohio and DESS. These agreements involve untariffed, non-utility services. DE-Indiana indicated all of its affiliate transactions were covered by agreements. Copies of the written agreements are on file with the IURC.

B. Findings

DE-Indiana's latest 10-K Report stated that it engages in related-party transactions that are generally performed at cost and in accordance with applicable state and federal commission regulations. Service Company charges to DE-Indiana were shown as $279 million for 2007, which is consistent with the amount (approximately $281 million) that Liberty calculated from detailed Service Company data. The report contains no specific disclosures concerning transactions with any other affiliates. The 10-K report does, however, discuss DE-Indiana's participation in a money pool with other Duke Energy subsidiaries.

The Service Company Agreement lists the services that the Service Company provides to DE-Indiana and the other regulated utilities. The following table summarizes them.

Service Company Agreement Functions

Information Systems	Human Resources	Accounting
Finance	Public Affairs	Legal
Internal Auditing	Investor Relations	Planning
Executive	Transportation	Rates
Meters	Materials Management	Facilities
Fuels	Rights of Way	Marketing/Customer Relations
Power Engineering/Construction	Power Planning and Operations	Environmental, Health and Safety
Electric System Maintenance	T&D Engineering and Construction	

The Service Company provides the same untariffed services to certain non-utility affiliates under the Service Company Non-utility Service Agreement, which contains the same cost allocation methods as the agreement with the utility entities.

DE-Indiana provides untariffed utility-related services to its utility affiliates under the Operating Agreement, and to non-utility affiliates under the Non-utility Agreement. When specifically asked, DE-Indiana identified as untariffed services only those that it provided to non-utility affiliates. Liberty believes that the goods and services provided by DE-Indiana to its utility affiliates, and vice versa, are also untariffed. Liberty interpreted Standard E in this way, and examined whether DE-Indiana complied with the standard for any of its affiliate transactions.

The Operating Agreement authorizes the utility parties, DE-Carolinas, DE-Indiana, DE-Kentucky, DE-Ohio, and Miami Power, to perform services for one another in areas such as engineering and construction, operation and maintenance, installation, equipment testing, generation technical support, environmental, health and safety, and procurement. A utility party may also lend employees to another, provided that such loans do not interfere with the providing utility's business operations or utility responsibilities.

The parties to the Non-utility Agreement comprise DE-Indiana, on the one hand, and non-utility affiliates who execute the agreement, on the other hand. Under the agreement, DE-Indiana may perform the same services (*e.g.*, engineering and construction and equipment testing) for a non-utility affiliate as it does for other utilities. Non-utility affiliates may provide services in such areas as information technology (IT) 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. The parties may also lend employees to one another, provided that such loans do not interfere with the utility's responsibilities or business operations.

DE-Indiana received during the audit period services from three non-utility affiliates: Cinergy Power Generation Services, Cinergy Capital and Trading, and DENA Global Asset Development. Total charges were approximately $15,000. DE-Indiana provided over $1 million in total services to the following non-utility affiliates during the audit period:

- Cinergy Power Generation
- Cinergy Solutions of Philadelphia
- Cinergy Solutions of Tuscola
- Cinergy Solutions Utility
- Duke Energy One
- DukeNet Communications.

Liberty asked accounting personnel to identify the IURC retention requirements that apply to accounting entries, contracts, and other written arrangements related to the provision of goods and services to an affiliate. The company provided the relevant

section of the Indiana Administrative Code, 170 IAC 4-1-3. The code states that all records must be preserved for at least three years, except as otherwise provided. Liberty asked accounting personnel to provide Duke Energy's record retention policy related to affiliate transactions. Journal entries and supporting detail in financial areas are to be retained for 50 years. Corporate policy is to retain labor distribution records for six years. The record retention policy for contracts is six years after cancellation or expiration.

Liberty's transaction testing in the audit of merger-related agreements and affiliate transactions examined a considerable number of transactions. The company was able to provide supporting accounting entries for itemized charges in all cases. Charges were sufficiently itemized, and were identified by resource type (*e.g.*, labor, materials, and accounts payable). Liberty did not specifically review accounting entries associated with agreements other than the merger-related agreements. However, the company accounts for these transactions in essentially the same way as transactions under the merger-related agreements.

C. Conclusions

1. DE-Indiana complied with Standard E during the audit period.

All agreements covering DE-Indiana's affiliate transactions are on file with the IURC. During testing, Liberty found that accounting personnel were able to produce adequate accounting entries to support itemized charges, and concluded that DE-Indiana had complied with IURC record retention policy.

D. Recommendations

Liberty has no recommendations regarding Standard E.

V. Standard F: Goods or Services from Non-utility Affiliates

A. Background

Standard F states that any good or service provided by a non-utility affiliate to DE-Indiana should be itemized in accounting entries pursuant to a written contract or agreement. DE-Indiana and the non-utility affiliate must maintain and make available for inspection copies of all accounting entries and each contract or arrangement that relate to the provision of such goods and services.

Non-utility affiliates provide goods and services to DE-Indiana; all transactions are governed by the Non-utility Agreement. Itemized inter-company charge data indicated that DE-Indiana received charges for goods and services from three non-utility affiliates during 2007: Cinergy Power Generation Services, Cinergy Capital and Trading, and DENA Global Asset Development. Total charges were approximately $15,000. Parent Cinergy Corp. also charged DE-Indiana $2.3 million in interest expense, related to the Money Pool Agreement, through journal entries. DE-Indiana's 10-K and 10-Q financial statements contain no disclosures concerning the services provided by non-utility affiliates.

B. Findings

During testing, Liberty reviewed the accounting entries associated with charges from Cinergy Capital and Trading. These charges were for labor and labor loaders. In this case, DE-Indiana was not charged overhead; therefore the utility was charged less than fully distributed cost. Transactions involving labor from a non-utility affiliate have been immaterial.

C. Conclusions

1. DE-Indiana complied with Standard F during the audit period.

The Non-utility Agreement is on file with the IURC and available for inspection. During testing, Liberty found that accounting personnel were able to produce journal entries, labor records, and supporting documents for services by non-utility affiliates, and concluded that DE-Indiana had complied with IURC record retention policy.

D. Recommendations

Liberty has no recommendations regarding Standard F.

VI. Standard G: Wholesale and Generation Operations

A. Background

Standard G requires that employees who manage DE-Indiana's wholesale merchant or generation functions and the employees of wholesale power affiliates ("wholesale power affiliates") operate independently to the maximum extent practical, and that DE-Indiana document all movement of employees between and among DE-Indiana and its affiliates.

B. Findings

1. Physical Separation

Nine companies comprise DE-Indiana's wholesale power affiliates. They are separate legal entities, but not necessarily operating companies with their own assets and distinct complements of employees. The employees responsible for DE-Indiana's wholesale merchant and generation functions and the employees who work for DE-Indiana's wholesale power affiliates operate from physical work locations on two floors of Duke Energy's Atrium II building in Cincinnati. The office spaces of the employees responsible for DE-Indiana's wholesale merchant and generation functions and the office spaces of the employees of DE-Indiana's wholesale power affiliates are separate. Each is clearly marked and entrances and exits have clearly marked signs distinguishing the spaces. All doors have card-access controls (ingress) or alarmed emergency doors (egress).

DE-Indiana has written procedures regarding access to the Atrium II office spaces on the 5th and 6th floors. These procedures provide processes for badges issuance, the sign-in process for visitors, the process for reviewing the visitor log for accuracy and compliance, restrictions on the use of conference rooms that are in either regulated or non-regulated areas, and the assignments of physical-access coordinators by floor and department.

2. Tracking Employee Movement

DE-Indiana and Duke Energy have the data readily available to track the movement of employees between departments. Liberty used that data to determine that there were almost 8,000 transfers of Duke Energy employees in 2007. The total number of employees involved was less than 8,000, as some employees were transferred more than once. From this universe Duke Energy identified, in a response to a document request, six transfers of employees involved with wholesale power. Four of these employees started in the business unit called Portfolio Optimization. The remaining two were in Commercial Business or Midwest Generation Operations (non-regulated entities). All of the identified transfers were to departments in Portfolio Optimization. The two departments (subsidiary organizational units in Portfolio Optimization) into which the transfers were made were DE-Indiana and DE-Kentucky Operations – Cincinnati and Bulk Power Marketing & Trading (regulated entities).

The level of transfer activity between DE-Indiana and its subsidiaries was balanced in 2007; 25 employees of DESS and two of DE-Ohio transferred to DE-Indiana, and 28 employees transferred from DE-Indiana to DESS and one transferred to DE-Ohio. The job descriptions of the employees who transferred to DE-Indiana generally indicated that they worked in T&D operations and customer service in both management and non-management positions. The employees who transferred from DE-Indiana were also in T&D operations and customer service positions, and also in production operations.

C. Conclusions

1. **The employees managing DE-Indiana's wholesale merchant or generation functions and the employees of affiliated wholesale power marketers operated with sufficient independence, and DE-Indiana documented movement of employees sufficiently to comply with Standard G.**

D. Recommandations

Liberty has no recommendations regarding Standard G.

VII. Standard H: Common Property Ownership

A. Background

With certain exceptions (described in Standards L and M, which are addressed below), DE-Indiana may not own property in common with a wholesale power affiliate.

B. Findings

Duke Energy attested that there was no property owned jointly by DE-Indiana and its wholesale power affiliates during 2007.

C. Conclusions

1. **DE-Indiana provided information verifying compliance with the joint ownership prohibition of Standard H.**

D. Recommendations

Liberty has no recommendations regarding Standard H.

VIII. Standard I: Sharing Information with Marketers

A. Background

Standard I prohibits DE-Indiana from sharing market information that is obtained in the conduct of its utility business with a wholesale power affiliate, except where such information has been publicly disseminated or simultaneously shared with, and made available to, non-affiliated entities who have requested such information. The standard also precludes the sharing of customer-specific information to a wholesale power affiliate except under the same terms as such information would be made available to a non-affiliated entity, and only with the written consent of the customer specifying the information to be released.

B. Findings

1. Customer Information

Liberty asked DE-Indiana to provide documents that described any instances in 2007 in which DE-Indiana disclosed to any third party, other than a permitted Duke Energy entity, confidential customer information. DE-Indiana's response was that it had not disclosed any such information without customers' consent or pursuant to a subpoena. Liberty followed up on that request with another, which asked for records of any disclosures of customer information. DE-Indiana's response was that a manager with relevant responsibility affirmed that DE-Indiana had no records of any disclosures of customer information in 2007.

Liberty asked DE-Indiana to confirm that there were no impermissible disclosures of confidential information about DE-Indiana customers in 2007. DE-Indiana reported that there had been no impermissible disclosures of confidential information about DE-Indiana customers in 2007. Neither DE-Indiana nor any other Duke Energy entity is aware of any complaints received during the audit period about improper releases of customer or market information.

Liberty asked DE-Indiana to provide the policies, procedures, and other guidance that address the provision of customer information by DE-Indiana or the Service Company to other Duke Energy companies. DE-Indiana's response was that Duke Energy follows the FERC Code of Conduct, which prohibits the sharing of market and customer information with a non-regulated affiliate unless the information is simultaneously disclosed publicly, and that Duke Energy requires its employees to annually take Web-based training on complying with the FERC Code of Conduct.

DE-Indiana does not have written policies and procedures regarding the process for obtaining customer consent to the release of customer information, and does not use forms to record requests from customers to permit the release of data about themselves. When customers ask for release of their information, customer-service representatives obtain information needed to verify the validity of the request and proceed according to customers' wishes. When a request comes from a third party, the requestor is instructed

that the release will only be allowed after DE-Indiana's Law Department receives a subpoena.

Liberty requested documents that describe the controls, including processes for obtaining approvals in database(s) of inquiries, customer permissions, and transactions and computer-system controls, used to ensure compliance with requirements with respect to the use of, and disclosure of, confidential customer information. DE-Indiana provided a five-page document, the CMS Access Request Procedure, which provides details about how to add, change, or delete employees from the employee table of CMS, Duke Energy's customer system. The procedure includes the requirement for reviewing detailed information that must be supplied on the employee, including organizational affiliation, identification of supervisor, and dollar-authorization level. This is the kind of information that would ordinarily be needed for normal utility security to prevent employees from making unauthorized changes to customer accounts. It is not specific to preventing unauthorized access to non-public customer information, and does not take into account requests for information about industrial and large commercial customers that could be valuable to Duke Energy's non-regulated affiliates or unaffiliated third parties.

2. Market Information

A Duke Energy manager with relevant responsibilities for DE-Indiana attested, in response to a Liberty data request, that during the audit period there were no requests for DE-Indiana market information made by affiliated or non-affiliated entities, and there were no requests for DE-Indiana market information obtained in the conduct of its utility business by a wholesale power affiliate.

Liberty asked DE-Indiana for the policies, procedures, and other guidance that address the provision of DE-Indiana's market information by DE-Indiana or the Service Company to other Duke Energy companies and unaffiliated parties. DE-Indiana's response pointed to the materials used for training employees. Liberty also asked DE-Indiana for documents that described any instances in 2007 in which DE-Indiana disclosed to any third party DE-Indiana's market information. DE-Indiana had no such documentation because Standard I does not preclude the disclosure of market information to third parties.

Duke Energy does not have specific policies or other documents that describe DE-Indiana's process for identifying what is market information and making it clear to employees that it is to be treated as such. Instead, Duke Energy relies on its training programs to describe market information.

DE-Indiana used a number of packages of training materials during the audit period to make clear to employees the requirements established in Standard I, although the training materials are aimed at training to FERC rules and not specifically to Standard I.

One package (dated October 17, 2007) is called Contractor Code of Conduct No Conduit Rule Training. This training is aimed at contractors who are considered shared support

employees, working in support functions. In three pages of slides it defines the No Conduit Rule of FERC's Code of Conduct as prohibiting the sharing of market information (non-public information involving regulated or non-regulated entities on topics including sales, costs, outages, efficiencies, output, and unconsummated transactions) about Duke Energy's power plants with "sales and marketing employees that are not allowed to have access to this information." Shared support employees are allowed to have access to information about both regulated and non-regulated power plants but they must comply with the No Conduit Rule. The package includes advice not to share information on outages and maintenance during work and non-work time, and also provides names and telephone numbers of Compliance and Legal department personnel. There was also a Spanish-language version of this package.

The second package, the FERC Code of Conduct and Standards of Conduct Training (updated September 12, 2007), a computerized (Web-based) training, at more than 30 substantive pages total, is the most extensive training package. It explains what the FERC is, notes that the FERC Code of Conduct prohibits two-way sharing of information, and distinguishes between the Code of Conduct (affiliate relationships and market-based rates authority) and the Standards of Conduct (for transmission providers). Two substantial paragraphs are devoted to defining market information and describing the prohibition on disclosure of such information to employees of "wholesale merchant" companies unless the information is simultaneously disclosed to the public, and from "Duke's non-regulated businesses" to employees of regulated companies who are not shared-support employees. A page has six bulleted items of examples of market information, and there is also a page devoted to the "no conduit rule." There is a test section that uses examples. There is also a condensed version of this training, with about 20 substantive pages of training materials.

The training package also reinforces the need to use the FERC Transfer Toolkit. The toolkit is used to ensure that the access to IT systems and work areas of employees who transfer jobs that include information and functions relevant to the Code and Standards be reviewed, and if necessary, changed.

A presentation "Access Changes on ATII 5&6 to Comply with FERC Code of Conduct" (see the discussion of Standard G for more on the Atrium II office space) contains more than a dozen pages of substantive content. The presentation reinforces the need to follow the changes "to avoid FERC Code of Conduct violations, and reinforces the importance of compliance, provides a "refresher" on the restrictions of the Code of Conduct and on the "no-conduit" rule. After that introductory material, there is a page devoted to discussing FERC's preference for a "culture of separation" and the recent citation of FERC finding utility, Progress Energy in violation. There follows an explanation of why the access to the work spaces in the Atrium II building were changed to preclude employees of regulated and non-regulated companies going between each others' work spaces, with the continued exception for shared services employees.

An e-mailed memorandum (dated September 14, 2007) sent from two Duke Energy officers responsible for compliance to employees "impacted" by the FERC Code of

Conduct constituted another training package. The one-page message explained the change in FERC regulations (effective September 18, 2007) that prohibits two-way sharing of non-public market information except for shared-support employees and the extension of the two-way restriction to the no-conduit rule. Besides informing employees of the change in FERC regulation, the memorandum alerts employees to be vigilant about communications of information and who attends meetings, that the Compliance and Legal departments will help in reviewing that IT systems comply with the new requirements, and that employees will be asked to (re-)take the required annual computerized (Web-based) training. Liberty asked DE-Indiana in a follow-up request for documents that described the process and products of the review of the compliance of IT systems. DE-Indiana had no such documents.

Liberty requested documents that describe controls, including processes for obtaining approvals in Duke Energy, database(s) of inquiries and transactions, and computer-system controls that Duke Energy uses to ensure that it complies with requirements with respect to the use of, and disclosure of, DE-Indiana's market information. DE-Indiana's response was a set of six documents.

- Two pages of procedures on CXL, a system used for energy trading, including how: employees are granted access; passwords are reset; changes in authorization are made; and user-access is reviewed quarterly. In an interview Liberty was also given similar documentation on ComTrac (Commodity Tracking), the fuels management system used to administer fuel shipments, contracts, inventory, quality, and fuels accounting.
- Thirteen pages of reference material, in five documents, on how to manage the transfer of employees into and out of "FERC-impacted" (transfers between regulated or non-regulated wholesale-merchant or transmission functions) and "FERC-related" (transfers between shared-support functions and regulated or non-regulated wholesale-merchant or transmission functions) positions. Both kinds of transfers have multiple parts, but the "FERC-impacted" transfers have more requirements.

Liberty asked DE-Indiana again for documents responsive to all elements of that request. DE-Indiana replied that it had no other documents.

DE-Indiana reported, through its FERC Order 2004 Compliance Log, three incidents where market information was incorrectly disclosed in 2007. The first occurred in April. An employee of Duke Energy Generation Services inadvertently learned that DE-Indiana might buy some wind turbines. The communication involved was then posted on Duke Energy's FERC Web page. The second and third incidents occurred in December. One involved a mistake in sending reports on non-regulated gas storage data to employees of regulated companies, and vice versa. The error was corrected by recalling the e-mails and asking all of the employees who received them to delete them. The third involved an employee of a non-regulated company who accessed the ComTrac system and found information about coal at Gibson Station, which is a regulated DE-Indiana plant. The resolution was that the vendor of ComTrac changed the system; testing showed that the access flaw was fixed.

C. Conclusions

1. **DE-Indiana undertook adequate efforts to comply with the information-sharing requirements of Standard I.**

D. Recommendations

Liberty has no recommendations regarding Standard I.

IX. Standard J: Name and Logo Sharing

A. Background

Standard J allows a non-utility affiliate of DE-Indiana to use its name or logo only if DE-Indiana's affiliate makes adequate disclosures that the two entities are separate, that it is not necessary to purchase the goods or services from the affiliate to obtain utility service, and that customers will gain no advantage if they buy from the affiliate.

B. Findings

DE-Indiana stated that no non-utility affiliates used DE-Indiana's name or logo. The company provided Duke Energy's Brand Standards (a statement of policy with detailed guidance on the use of company's name and logo, etc.) which states: "...[O]ur franchised electric and gas utilities will use a single company name – Duke Energy. It also says that:

> *Some employees and executives who interact with state regulatory commissions and other ... agencies will identify their businesses as Duke Energy Carolinas, Duke Energy Indiana .... However, these names and their corresponding logos will not be widely used.*

Duke Energy has four state "geographical identifiers," which comprises the term used for the names of the utility companies in the Carolinas, Indiana, Ohio, and Kentucky, e.g., Duke Energy Indiana. The Brand Standards further instruct:

> *The geographic identifiers ... are to be used only in the following applications:*
>
> - *Regulatory filings in the ... jurisdictions and in other ... documents (press releases ...) referring to those filings, and on reports specific to the utility that are presented to regulators .... Examples are financial reports, customer data, etc.*
> - *Business cards, stationery of large customer/regulator/legislator-facing employees ... this applies to all employees in the organizations reporting to the utility presidents*
>
> *In other, non-regulatory-driven communications ... refer to Duke Energy only and use the Duke Energy logo [the words Duke Energy next to a D with a swirl]. Such communications may describe regional operations: for example, an economic development brochure might refer to "doing business in the Carolinas" .... Geographic identifiers should be avoided in these uses.*
>
> *Geographic identifier logos should not be used on hard hats, vehicles, signage or logo merchandise.*

The document also states that:

> *Some of our businesses have a need to identify strongly with the Duke Energy brand, yet be distinguished from the regulated utilities as independent affiliates.*
>
> - *Duke Energy Americas and Duke Energy International continue to use their respective names.*
> - *Cinergy Solutions has become Duke Energy Generation Services.*

C. Conclusions

1. **There are adequate procedures to prevent the uses of names and logos prohibited by Standard J.**

D. Recommandations

Liberty has no recommendations regarding Standard J.

X. Standard K: Tying

A. Background

Standard K prohibits DE-Indiana from tying or conditioning the provision of any goods or services to the purchase of any goods or services from a wholesale power affiliate.

B. Findings

Liberty asked DE-Indiana for all contracts between DE-Indiana's wholesale power affiliates and any DE-Indiana customer that were in force during the audit period. DE-Indiana stated that there were no contracts between DE-Indiana's wholesale power affiliates and any DE-Indiana customer during the audit period.

C. Conclusions

1. **There were no agreements in effect during the audit period to which the tying and conditioning provisions of Standard K would apply.**

D. Recommendations

Liberty has no recommendations regarding Standard K.

XI. Standards L and M: Space, Equipment, System Sharing

A. Background

Standard L requires, subject to the exception of Standard M, that employees of DE-Indiana's wholesale power affiliates not share office space, office equipment, computer systems, or information systems with DE-Indiana's employees. The sharing of computer systems and information systems is permissible if those systems are secured in a way that precludes employees of DE-Indiana's wholesale power affiliates from accessing DE-Indiana's data. The office space can be shared "under a lease or other ownership arrangement if the office space is secured such that employees of one company cannot access the designated office area of the other." The Standard M exception allows the sharing of computer systems and information systems "only to the extent necessary for the provision of corporate support services or other shared services," again with the proviso that there are safeguards that ensure compliance with the Affiliate Standards.

B. Findings

1. Office Space

Liberty asked DE-Indiana to provide the floor plans, lease agreements, and any other appropriate descriptions of physical locations of office space occupied by DE-Indiana and any wholesale power affiliates, with indication of any space occupied by both DE-Indiana and a wholesale power affiliate, or a representation stating that no office space was occupied by DE-Indiana and a wholesale power affiliate during the audit period. Two Duke Energy management employees provided such a representation. The manager of facilities maintenance for DE-Indiana attested that there was no office space shared by DE-Indiana and a wholesale power affiliate during the audit period. The real estate services manager, Duke Energy Midwest, attested that there was no office space shared by DE-Ohio and DE-Kentucky and a wholesale power affiliate during the audit period. Because there was no sharing of space there was also no sharing of office equipment.

A Liberty consultant visited Duke Energy office space in Cincinnati (discussed also in the sections of this chapter pertaining to Standards G and I) where DE-Indiana and wholesale power affiliates conduct wholesale-market activities for their respective companies. Liberty found that the office spaces occupied by the employees of the respective companies were distinctly separate and securely separated.

2. Information Systems

Liberty asked DE-Indiana for descriptions of any computer systems and information systems that DE-Indiana and any wholesale power affiliate shared, other than computer systems and information systems shared between DE-Indiana and any wholesale power affiliate as necessary for the provision of corporate-support services or other shared services. DE-Indiana identified three such systems:

- nMarket, which is used in bidding and settlements in PJM and MISO
- CXL, used to support trading
- ComTrac, used for managing the procurement and supply of fossil fuels.

DE-Indiana also provided information on the security processes applied to each system.

Liberty asked Duke Energy for a current list of employees who have access to systems that contain DE-Indiana customer or market information, including system-access information for each employee. DE-Indiana had no such list available. After several telephone conferences on the subject DE-Indiana proceeded to compile the list, which covered over 30 applications and included about 7,600 lines of information in an Excel file (*"Indiana Audit System Access Data - All v2*). Each line represented a unique user for a system. Liberty used that Excel file to test DE-Indiana's understanding that nMarket, CXL, and ComTrac were the only systems that DE-Indiana and any wholesale power affiliate shared, other than systems used for the provision of corporate-support services. Liberty's testing confirmed DE-Indiana's understanding, with the exception of two employees of a wholesale power affiliate (DENA Asset Partners LP) who use WEBDISPATCH. About 150 DE-Indiana employees also use that system, for generation instruction and unit-derate communication between load coordinators on the trading floor and unit operators at the generating stations.

Liberty conducted additional testing of security access, and also conducted an interview on the subject of access-control management processes. Liberty used the Excel file to randomly selected 11 employees to test, including five who worked for a wholesale power affiliate and had access to systems that would have DE-Indiana market or customer information. These systems included CXL, WEBDISPATCH, Environmental Balanced Scorecard (EBS), MV90 and EE (applications used for meters on large customers). The other six employees selected were Duke Energy "strategic business users," who had access to these systems and other systems. Those systems include:

- CEMS: used for compliance with air-emission regulations
- MicroGads Gold: used for tracking and reporting of generation-availability data (GADS).

The six employees should only have had access to information about non-utility businesses.

Liberty told DE-Indiana of its testing choices in advance; DE-Indiana alerted Liberty to the following problems:

- Two of the employees identified as CXL users had never used it.
- One of the WEBDISPATCH users selected had never used that system.
- The EBS user selected had never used the system.
- One of the MV90 and EE users switched groups and was not using MV90 or EE.
- A user of CEMS and ComTrac had never used either system.
- A user of EMS, MicroGads Gold, and WEBDISPATCH had been transferred and no longer used any of those systems.
- A user of MicroGads Gold and ComTrac had left the company.

Liberty then added two additional DE-Indiana users and three additional DE-Ohio users. During the testing session Liberty met with IT personnel who checked the access of additional personnel. The total number of people tested for each system were:

MV90	1	WEBDISPATCH	2
EE	1	CXL	6
ComTrac	2	EBS	1
MicroGads Gold	5		

The testing involved asking the appropriate Duke Energy personnel to provide information on each employee's job title, job description, and where the employee was employed. Liberty worked with several individuals from the IT department to observe the level of information accessible using each employee's log-in ID in the various systems. Liberty made observations in particular on whether a DE-Indiana employee is able to access information that belongs to a wholesale power affiliate and *vice versa.*

Liberty's testing found that appropriate segmented access was set up in the ComTrac, CXL, and WEBDISPATCH systems. MicroGads Gold was designed with segmented access; however, Liberty found one employee with access to information for both DE-Indiana and DE-Ohio plants. The EBS system did not have any segmented or layered access; however, Company personnel indicated that the system was being phased out, and had not been updated since before the audit period. Liberty also found instances of individuals who had access to systems that they had never used, or had not accessed in several years due to new job responsibilities.

During the testing, Duke Energy informed Liberty that employee access to systems is tested twice a year by the Company's Internal Audit group, and that Duke Energy's external auditors review CXL and ComTrac access as part of their Sarbanes-Oxley review programs.

C. Conclusions

1. DE-Indiana does not apply a sufficiently structured and comprehensive approach to assuring compliance with Standards L and M. *(Recommendation #1)*

Liberty reads the Standards as requiring DE-Indiana and its affiliates to take affirmative steps to assure its compliance with the Standards. Until Liberty began audit work DE-Indiana had not taken substantial steps to address Standards L and M specifically. Liberty's testing found that Duke Energy employees:

- Had access to systems that are not required for their job responsibilities
- Had access to systems they have not needed or accessed for substantial amounts of time
- Some Duke employees have access to information that crosses the "regulated and non-regulated" boundary.

D. Recommendations

1. Initiate a comprehensive program to comply with Standards L and M. *(Conclusion #1)*

DE-Indiana should immediately compile and then assign sufficient resources to the maintenance of an accurate and up-to-date list of databases with market or confidential information that requires protection and that includes a list of all individuals who have access to each of these systems. Further, DE-Indiana should make system-access testing a part of an annual internal audit.

XII. Standard N: Limits on Corporate Support to Affiliates

A. Background

Standard N allows DE-Indiana to engage in transactions for the provision of corporate-support services but precludes DE-Indiana's provision of corporate-support services to its affiliates in a way that would transfer DE-Indiana's confidential information, proffer an advantage, allow for cross-subsidization, or otherwise provide a way to circumvent the Standards.

B. Findings

Liberty asked DE-Indiana to provide a list of all affiliates for which it provides corporate-support services, including a description of any services provided, and if DE-Indiana provided no corporate-support services to any affiliates during the audit period, to provide a representation stating that. DE-Indiana stated that it does not provide such services to any affiliates, and that all such services are provided by DEBS and DESS.

Liberty asked DE-Indiana to describe the internal controls that ensure that the provision of corporate-support services do not provide a means for the transfer of confidential information from DE-Indiana to its affiliates, create the opportunity for preferential treatment or unfair competitive advantage, create opportunities for cross-subsidization of affiliates, or otherwise provide any means to circumvent the Affiliate Standards. DE-Indiana's response was that it follows the FERC Code of Conduct, which is embodied in the training that Duke Energy does on the Code of Conduct. Liberty's audit work on Standard I describes the training materials.

C. Conclusions

1. DE-Indiana complies with Standard N.

DE-Indiana's representation that it provides no corporate-support services means that it complies with the Standard.

D. Recommandations

Liberty has no recommendations regarding Standard N.

XIII. Standard O: Availability to Third Parties

A. Background

With the exceptions for corporate support services allowed by Standard N, Standard O allows DE-Indiana to make goods or services available to a wholesale power affiliate only if the goods or services are equally available to all non-affiliated wholesale power marketers, and on a non-discriminatory basis.

B. Findings

Duke Energy's vice president of bulk power marketing attested that there were no products or services provided by DE-Indiana to any wholesale power affiliate during the audit period.

C. Conclusions

1. **There were no agreements in effect during the audit period to which the third-party availability provisions of Standard O would apply.**

D. Recommendations

Liberty has no recommendations regarding Standard O.

XIV. Standard P: Documentation

A. Background

Standard P states that, if DE-Indiana provides both regulated and non-regulated goods and services, or if an affiliate provides services and goods to DE-Indiana, both DE-Indiana and the affiliate should maintain documentation in the form of written agreements, organization charts, accounting bulletins, procedure and work order manuals, and other related documents that describe how costs are allocated between regulated and non-regulated services or goods.

The distinction between "regulated" and "non-regulated" goods and services is not always clear. Liberty therefore interpreted Standard P broadly, and examined whether DE-Indiana maintained sufficient documentation for all transactions with affiliates, regardless of whether they involved regulated or non-regulated goods and services.

B. Findings

The Service Company provides traditional and utility-related services to DE-Indiana subject to the Service Company Agreement. DE-Indiana and its utility affiliates provide utility-related goods and services to each other subject to the Operating Agreement. DE-Indiana provides similar utility-related goods and services to its non-utility affiliates subject to the Non-utility Companies Service Agreement. Non-utility affiliates provide DE-Indiana with small amounts of goods and services subject to the same agreement. DE-Indiana is also a part to the Money Pool Agreement; Liberty did not consider charges under the agreement to be affiliate transactions.

DE-Indiana is also a party to agreements with affiliates other than these three merger-related agreements, such as the Master Transmission Tower Licensing Agreement with DukeNet Communications, and the Interconnection Agreement with DE-Ohio and DESS. DE-Indiana filed final versions of the three merger-related agreements with the IURC in May 2006, and filed amendments in November 2007. DE-Indiana filed copies of its other agreements with its affiliates as part of its Annual Informational Filing at the IURC. DE-Indiana indicated all of its affiliate transactions were covered by agreements.

Duke Energy maintains detailed organization charts and general accounting policies and procedures in its on-line documentation system. The company also has well-documented procedures and practices regarding the use of work orders. The written policy regarding accounting for affiliate transactions provides general descriptions of the methods of recording inter-company transactions, settlement, and reconciliation, but provides little detail on how to process individual affiliate transactions.

Affiliate transaction documentation should be sufficient to establish clear rules for pricing all services, should provide for clear and consistent methods for price determinations, and should be in accordance with requirements established by regulatory standards. Typically, utilities maintain a formal Cost Allocation Manual (CAM), or similarly named document to express the official statement of a company's policies and procedures on distributing costs among subsidiaries, and to provide a reference on the

subject for employees and guidance as to why particular kinds of costs are distributed in specific ways. Liberty normally reviews a company's CAM to determine if it is reasonably complete, and whether it would provide sufficient guidance in pricing services. In particular, the company's methods for directly charging, directly assigning, or allocating charges should be clear and adequately documented.

The following are criteria that Liberty applies when it evaluates the clarity and completeness of governing documents and procedures related to accounting for affiliate transactions:

- There should be sufficient documentation to establish clear rules for pricing all services.
- The rules should provide for a clear and consistent set of methods for price determinations.
- The rules should be in accordance with requirements established by regulatory standards.

DE-Indiana is not required to have a CAM, and does not have one.

C. Conclusions

1. DE-Indiana met most of the requirements of Standard P during the audit period, but its documentation regarding cost allocation methods was not sufficiently detailed. *(Recommendation #1)*

DE-Indiana maintains formal written agreements covering its transactions with affiliates. The company maintains organizational charts and adequate higher-level documentation on policies and procedures, but more detailed information has not been formalized.

D. Recommendations

1. Develop and maintain a formal affiliate transaction accounting manual. *(Conclusion #1)*

Although DE-Indiana is not required by the IURC to maintain a CAM, Standard P and good utility practice justify having one in place. The consolidation of Duke Energy utility affiliates under the same accounting system in mid-2008 provides a good opportunity for Duke Energy to develop a new affiliate transactions accounting manual applicable to all affiliates, including DE-Indiana.

Liberty has made the same recommendation regarding a formal detailed accounting manual in its companion report summarizing the audit of DE-Indiana affiliate transactions.

XV. Standards Q, R, and S: Contact Designations

A. Background

Standard Q requires DE-Indiana to designate an employee to be a contact for the IURC and the OUCC for information regarding DE-Indiana's affiliate transactions and personnel transfers. Standard R imposes a similar requirement for IURC inquiries on retail-consumer issues regarding service and reliability concerns, and Standard S requires DE-Indiana to provide the IURC with a current list of employees or agents designated to work with the IURC and the OUCC on state-regulatory matters.

B. Findings

In response to data requests, DE-Indiana provided Liberty with a copy of a letter sent on March 8, 2007 to the executive secretary of the IURC. The letter provided names, titles, and telephone numbers for contacts for information on affiliate transactions and personnel transfers, service and reliability concerns, and state-regulatory matters, (including rate cases, consumer complaints and billing issues). A representative of Duke Energy's Human Resources Client Services department attested in April 2008 that the employees listed in the letter were active employees.

C. Conclusions

1. **DE-Indiana complied with the designation requirements of Standards Q, R, and S.**

D. Recommendations

Liberty has no recommendations regarding Standards Q, R, and S.

XVI. Standard T: Affiliate Contract Filings

A. Background

Standard T calls for DE-Indiana to follow a set of procedures regarding the filing of affiliate contracts with the IURC, SEC, and/or FERC.

B. Findings

A DE-Indiana attorney with relevant responsibilities, on behalf of Duke Energy's Office of General Counsel, attested in a response to a Liberty document request that DE-Indiana did not file with the IURC during the audit period any affiliate contracts that required specific approval of the IURC, in compliance with Ind. Code §§ 8-1-2-83 and 8-1-2-84. The same attorney attested that no affiliate contracts were filed during the audit period with the IURC that were disapproved. Another attorney whose responsibilities include making filings with FERC attested that there were no filings with FERC of affiliate contracts during the audit period. A third attorney, in the Office of General Counsel of Duke Energy, attested that no affiliate contracts were filed with the SEC during the audit period.

Liberty also asked DE-Indiana for a listing of all affiliate contracts, including service agreements, not required to be filed with the SEC or the FERC that were required to be filed with the IURC and OUCC during the audit period. The only such agreements were submitted to the IURC and OUCC on December 19 and 26, 2007. The agreements, with explanatory cover letters, were inter-company and utility-to-non-utility asset transfer agreements and an amended and restated master transmission-tower attachment license agreement.

C. Conclusions

1. DE-Indiana complied with Standard T.

D. Recommendations

Liberty has no recommendations regarding Standard T.

XVII. Standard V: Audits and Controls

A. Background

Standard V calls for four independent audits (this report addresses the first) of compliance with the Affiliate Standards and of the sufficiency of DE-Indiana's controls and training aimed at assuring such compliance.

B. Findings

Liberty asked DE-Indiana for documents summarizing the processes, controls, or results of testing associated with Sarbanes-Oxley requirements related to affiliate transactions that were prepared or updated during 2007. DE-Indiana's response provided nothing specific on the topic.

Liberty also asked DE-Indiana for documents prepared or updated during the audit period as part of DE-Indiana's or Duke Energy's activities aimed at assuring compliance with the Sarbanes-Oxley Act generally, and section 404 in particular, on the topic of DE-Indiana's or Duke Energy's compliance with the Affiliate Standards or that dealt with the subject of internal controls aimed at assuring DE-Indiana's or Duke Energy's compliance. DE-Indiana indicated that there was no specific testing or other Sarbanes-Oxley Act activity aimed at assuring compliance with the Sarbanes-Oxley Act generally, and its section 404 in particular, on the topic of DE-Indiana's or Duke Energy's compliance with the Affiliate Standards. In addition, DE-Indiana had no other documentation of controls whose purpose was to assure DE-Indiana's or Duke Energy's compliance with the standards.

Liberty asked DE-Indiana for documents that show: (a) all DE-Indiana and any other Duke Energy training sessions conducted during the audit period associated with the Affiliate Standards, including descriptions of the training that was provided, (b) the criteria used for determining which organizational units had employees who should attend the training, and (c) which employees designated to receive training did and those who did not receive the training during the audit period. DE-Indiana's response was the attendance sheet for one classroom training session conducted on January 8, 2007 that had eight students, and a memorandum dated October 13, 2006 that provided one page of background and direction on requirements for compliance with the codes of conduct and merger conditions of the states that approved the merger of Duke Energy and Cinergy.

C. Conclusions

1. **DE-Indiana had no specific program or activities whose purpose is compliance with Standard V and the Affiliate Standards.** *(Recommendation #1)*

D. Recommendations

1. **Initiate a comprehensive program that will start DE-Indiana on a path to compliance with Standard V and the Affiliate Standards.** *(Conclusion #1)*

DE-Indiana should immediately undertake an expansive effort to remedy this deficiency, with the objective of completing one cycle before the next audit begins.

XVIII. Standard Z: Approval of Power Purchases

A. Background

Standard Z requires that the company seek IURC acceptance and approval for any proposed purchase of firm power or unit power by DE-Indiana from an affiliate for a term of five years or more.

B. Findings

A DE-Indiana attorney with relevant responsibilities, on behalf of Duke Energy's Office of General Counsel, attested in a response to a Liberty document request that DE-Indiana did not seek IURC approval of any proposed purchase of firm power or unit power during the audit period because no such purchases met the approval threshold.

C. Conclusions

1. **There were no purchases during the audit period to which the requirements of Standard Z would apply.**

D. Recommendations

Liberty has no recommendations regarding Standard Z.

XIX. Informational Filings

A. Background

Section III of the Affiliate Standards include requirements for DE-Indiana to make Annual Informational Filings, Additional Annual Informational Filings, and Special Informational Filings.

B. Findings

1. Annual Informational Filings

Liberty reviewed DE-Indiana's filings for compliance with the following requirements:

- The names and business addresses of the officers and directors of each affiliate
- A description of each affiliate's business purpose(s), including a description of any diversification policy
- An organization chart showing DE-Indiana, such affiliates, and their relationship to each other
- A description of the method(s) used to identify, value, and record transfers of Assets, Goods and Services between DE-Indiana and such affiliates
- A description of the method used to allocate federal and state income tax expense, payments and refunds to DE-Indiana and such affiliates
- A description of specific transfers of assets, goods or services between DE-Indiana and such affiliates during the applicable period, and a description of the transfer value(s) utilized for such transfers.

The required names and addresses, organization charts, methods descriptions, and personnel transfers were reported.

Liberty found a number of issues with the affiliate information:

- An error in the business description of Duke Technologies, Inc.
- The description of Carolinas Virginia Nuclear Power Associates Inc. as "non-profit" could be enhanced
- The information that an officer of some of the U.K. subsidiaries is "Chance, Clifford" appears to be in error; Clifford, Chance is a law firm
- No business purpose was listed for Piedmont Venture Partners Limited Partnership.

With respect to asset transfers, the answer did not describe specific transfers.

2. Additional Annual Informational Filings

Liberty reviewed DE-Indiana's filings for compliance, with the following results:

- The capital structure of each such affiliate as of the end of the applicable period
- A statement of the changes in the capital structure of each such affiliate during the applicable period

- An assessment of the effects on DE-Indiana's capital structure and DE-Indiana's ability to attract capital due to the activities of each such affiliate during the applicable period
- If requested by the IURC or the OUCC, the names and job descriptions of any employees of DE-Indiana transferred to, or for whom seventy-five percent (75%) or more of their time has been allocated to such an affiliate during the applicable period
- Any amendments to the Utility Money Pool Agreement made in the previous calendar year.

Liberty found that the required information about capital structure, changes thereto, and money pool agreement changes was provided. An assessment of the ability to attract capital was also provided. There was no occasion to respond to a request for information about employee transfers or time allocations.

3. Special Informational Filing

Section III also requires DE-Indiana to make a special informational filing detailing the transfer to a non-utility affiliate of confidential utility information, including customer lists, to be used for non-utility purposes. The same requirement applies to transfers of any intellectual property whose original cost exceeds $500,000. DE-Indiana's filing indicated that there were no such transfers. This does not appear, however, to be correct. A response to a request for documents that Liberty made for a list of each transaction by which DE-Indiana made customer information available to an affiliate in 2007 stated that the company gave the name and addresses of 12,500 customers to affiliate Duke Energy One over the period of April 1 to September 7, 2007.

C. Conclusions

1. With the exception of some aspects of the Annual Informational Filings and Special Informational Filing, the Informational Filings were complete and appeared to be accurate.

Liberty found some errors in the Annual Informational Filings, and part of the negative declaration about the Special Informational Filing was contradicted by a different source of information.

D. Recommendations

1. Correct the errors in the Informational Filings, re-submit the Filings, and institute a quality control process for assuring accurate reporting.