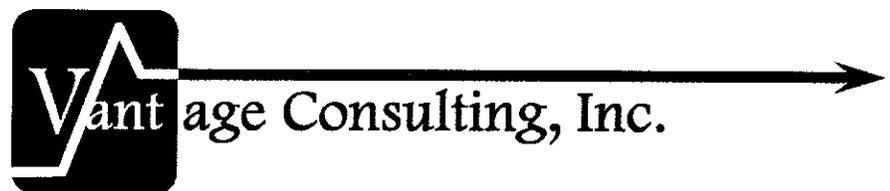


**Confidential Report
Compliance Audit
Of
Duke Energy Indiana
On Behalf Of
Indiana Utility Regulatory Commission
December 287, 2010**



Compliance Audit of Duke Energy - Indiana

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I. EXECUTIVE SUMMARY

A. BACKGROUND

Duke Energy Indiana (DE-Indiana) engages in the business of supplying electric generation, transmission, and distribution service to approximately 775,000 residential, commercial, and industrial customers in central, north central, and southern Indiana. In 2006, Cinergy Corp. (Cinergy), the parent company of PSI Energy, Inc. (PSI), subsequently renamed DE-Indiana, merged with Duke Energy Corporation (Duke Energy). As part of its approval, the Indiana Utility Regulatory Commission (IURC) adopted Affiliate Standards for DE-Indiana, as well as merger conditions whereby PSI committed to prevent cross-subsidization in its transactions with affiliates.

In its March 15, 2006 Order in Cause No. 42873 approving the merger, the IURC required a series of four biennial audits of DE-Indiana's compliance with its Affiliate Standards, including the training and controls put in place to prevent cross-subsidization. The first of these four audits has been completed. The Indiana Department of Administration issued a request for proposal (RFP) on behalf of the Indiana Office of Utility Consumer Counselor (OUCC) to solicit proposals for the second audit covering the period of January 1, 2009 through December 31, 2009. Vantage Consulting, Inc. (Vantage) was selected to perform this assignment.

B. PROJECT SCOPE AND METHODOLOGY

This audit provides the findings, conclusions and recommendations of Vantage concerning DE-Indiana's compliance with the established Affiliate Standards. The findings, conclusions and recommendations presented in this audit were developed by following the Work Plan for the audit as presented in the Vantage proposal and modified based on initial discovery and discussions with DE-Indiana.

The scope of the audit also includes offering an opinion as to whether DE-Indiana has successfully implemented the recommendations from the previous audit.

Vantage conducted this audit using Generally Accepted Government Auditing Standards (GAGAS). The auditors conducted sampling in accordance with Section 350 of the Generally Accepted Auditing Standards (GAAS). The Audit Work Plan is provided in our Proposal which is part of the contract to conduct this project.

In conducting this Compliance Audit, 69 Data Requests were made and answered and 14 interviews were held. In addition, numerous phone calls and e-mails were used to clear up details. Both the OUCC Staff and DE-Indiana representatives reviewed and commented on the Draft Report. Changes to the draft were made where appropriate.

C. REPORT ORGANIZATION

This report is organized into seven chapters, as described below. Each chapter is based on a functional theme and covers a number of Affiliate Standards.

Chapter I - Executive Summary – This chapter describes the project and the Vantage approach. Our overall conclusions are provided as well as a summary of recommendations.

Chapter II - Compliance – This chapter provides an overview of each affiliate standard and indicates whether DE-Indiana is in compliance with it.

Chapter III - Identification and Recording of Affiliate Transactions – This chapter addresses the actual treatment of affiliate transactions.

Chapter IV - Financial and Liability Separation–This chapter addresses Standards D, E, F and P which address financial and liability issues.

Chapter V - Affiliate Separation – Addresses affiliate Standard provisions G, H, I, J, K, L, M, N and O which deal with separation of operations and activities from other affiliates and subsidiaries.

Chapter VI - Controls and Training – Addresses results of analysis and review relative to the adequacy of the internal controls and training that DE-Indiana has in place to ensure compliance with the Affiliate Standards.

Chapter VII - Designations and Filing Requirements – Addresses Standards Q, R, S, T and Z which impact compliance to those directly involved in the regulation of the utility.

D. OVERALL CONCLUSIONS

DE-Indiana is in compliance with the Affiliate Standards reviewed by Vantage. The four recommendations made in the audit clarify and improve compliance and do not indicate any serious problems. Some of the key findings summarized below.

- DE-Indiana accurately accounts for affiliate transactions in accordance with regulatory requirements.
- DE-Indiana records all transactions with its affiliates in accordance with GAAP, and sufficient records are maintained to permit an audit of all transactions between DE-Indiana and its affiliates.
- A process has been developed to record and track asset transfers between the utility and non-utility affiliates.
- Recent Internal Audits associated with cost allocations and state affiliate standards provide recommendations for enhancements to the process.
- Many of the historical issues regarding finance and indebtedness were addressed in the previous audit and have not changed significantly.
- DE-Indiana has only two financial, operational, and other liability types (e.g., pension, environmental, energy trading), whose assignment among affiliates is possible.
- DE-Indiana files a consolidated Federal Income Tax return and allocates in accordance with the Provisions of the Tax Sharing Agreement.
- The policies and procedures associated with the utility Money Pool Agreement and the management of short-term cash and working capital are well documented and comply with all merger conditions.

- Non-utility services provided by DE-Indiana or the Service Company to an affiliate, and goods and services provided to DE-Indiana by a non-regulated affiliate, are covered by written agreements and are itemized in separate accounting entries.
- DE-Indiana retains sufficient documentation that describes how costs are allocated between regulated and non-regulated services.
- DE-Indiana is in compliance with Standards G, H and L, which requires the separation of DE-Indiana's wholesale merchant and generation functions from the employees of affiliate wholesale power marketers, and that DE-Indiana does not own any property in common with affiliate wholesale power marketers.
- During 2009, DE-Indiana did not provide any products or services to any affiliated wholesale power marketer or other third party marketer and therefore DE-Indiana is in compliance with Standard O.
- While the DE-Indiana's Indiana Affiliate Training and 2009 FERC Code/Standards of Conduct Training adequately identify and explain the compliance standards, they are very simplistic with few examples.
- DE-Indiana's process to make certain that the appropriate employees take the necessary training is not as formal as it could be.
- DE-Indiana's Annual Informational Filings meet all of the established compliance requirements.
- DE-Indiana, in response to the first audit, has prepared reasonable plans to implement each of the recommendations made in the audit.

E. Summary of Recommendations

Vantage offers the following recommendations.

III-R1 As part of the 2011 affiliate audit, provide details on fourth quarter 2009 transformer transfers

DE-Indiana indicated that due to a new system implementation, quantification of the transformers transferred for the period of October 2009 to December 2009, could not be provided until the next audit cycle.

III-R2 Provide details on changes related to the two internal audits conducted.

Provide the next auditors with details of the changes made in response to the two internal audit reports discussed in Finding III-2 and the impact of the changes.

VI-R1 Enhance affiliate training with more realistic examples that encourage the employee to think through the affiliate issue presented.

The Code of Business Ethics training has established a standard to which DE-Indiana should strive to reach with its Indiana Affiliate training. The current Indiana Affiliate training meets the minimum requirements through a mundane presentation of the affiliate standards and some trivial examples. The annual review of this material as currently presented will only be a necessity for the employees. The training would be much more effective if it were enlivened with better examples and a more interactive presentation of the standards.

VI-R2 Implement a set of formal procedures surrounding the provision of its Indiana Affiliate training.

In response to the issue that arose during the interview and through a follow-up data request, a draft of the training protocol currently under development by the Ethics and Compliance Department was provided.¹ The draft protocol establishes who the intended audience for the training is, when and how the training is offered, when the training should be updated, when reminders should be sent including reminders to immediate supervisors, and the maintenance of training records. The response indicated that the current plan is to implement the training protocol by the first quarter of 2011. Vantage recommends that this protocol for the Indiana Affiliate training be established no later than the planned date.

VII-R1 Provide contact information to the OUCC per Standards Q, R and S.

DE-Indiana provides the IURC with the contact information required by Standards Q, R and S. However, the Standards also require that the information be provided to the OUCC. In the future, DE-Indiana should provide the information not only to the IURC but also the OUCC.

¹/ DR 4.50

II COMPLIANCE

A. INTRODUCTION

This chapter provides an overview of each affiliate standard and indicates whether DE-Indiana is in compliance with it.

B. COMPLIANCE WITH AFFILIATE STANDARDS

The remainder of this chapter lists the relevant Affiliate Standards, states whether Vantage finds DE-Indiana in compliance with the standard and references where in the report the reader can find more detail regarding Vantage's findings, conclusions and recommendations related to each of the affiliate standards. In addition to examining the strict compliance with the Affiliate Standards, Vantage also reviewed and evaluated the controls and training that DE-Indiana utilizes to ensure its compliance with the Affiliate Standards. This review and evaluation is provided in Chapter VI.

Standard C: *In accordance with generally accepted accounting principles and consistent with state and federal guidelines, Company shall record all transactions with its Affiliates, whether direct or indirect. Company and its Affiliates shall maintain sufficient records to allow for an audit of the transactions involving Company and its Affiliates. Goods and Services provided by Company to a Non-Utility Affiliate, and Goods and Services provided by a Non-Utility Affiliate to Company, shall be accounted for in accordance with current requirements issued by the SEC or the FERC, whichever is applicable, or other statutory requirements if neither the SEC nor the FERC has jurisdiction. Asset transfers from Company to a Non-Utility Affiliate, and asset transfers from a Non-Utility Affiliate to Company, shall be accounted for in accordance with current requirements issued by the SEC or the FERC, whichever is applicable, or other statutory requirements if neither the SEC nor the FERC has jurisdiction.*

Vantage finds DE-Indiana is in compliance with Standard C. Vantage's analysis, findings and conclusions supporting its finding of compliance, is discussed further in Chapter III. Vantage also verified its conclusion through the sampling of selected transactions.

Standard D: *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 Company would be liable for the debts and/or liabilities of the Non-Utility Affiliate incurred as a result of 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.*

Vantage finds DE-Indiana is in compliance with Standard D. Vantage's analysis, findings and conclusions supporting its finding of compliance is discussed further in Chapter IV.

Standard E:*Any untariffed, Non-Utility Services provided by Company or the Service Company to any Affiliate shall be itemized in accounting entries (including electronic entries) pursuant to a written contract or written arrangement. Company and the Service Company shall maintain and keep available for inspection by the Commission copies of all accounting entries and each contract and arrangement between Company or the Service Company and Company's Affiliates that relate to the provision of such untariffed, Non-Utility Services.*

Vantage finds DE-Indiana is in compliance with Standard E. Vantage's analysis, findings and conclusions supporting its finding of compliance is discussed further in Chapter III.

Standard F:*Any Goods or Services provided by a Non-Utility Affiliate to Company shall be itemized in accounting entries (including electronic entries) pursuant to a written contract or written arrangement. Company and Non-Utility Affiliates shall maintain and keep available for inspection by the Commission copies of all accounting entries and each contract and arrangement between Company and its Non-Utility Affiliates that relate to the provision of such Goods and Services in accordance with the Commission's retention requirements.*

Vantage finds DE-Indiana is in compliance with Standard F. Vantage's analysis, findings and conclusions supporting its finding of compliance is discussed further in Chapter III.

Standard G:*Employees responsible for directing, organizing and executing the business decisions of Company's wholesale merchant or generation functions and those employees of Affiliated Wholesale Power Marketers shall operate independently of one another, to the maximum extent practical. Company shall document all employee movement between and among Company and its Affiliates. Such information shall be made available to the Commission and the OUCG upon request.*

Vantage finds DE-Indiana is in compliance with Standard G. Vantage's analysis, findings and conclusions supporting its finding of compliance is discussed further in Chapter V.

Standard H:*Except as provided in Standard (L) or Standard (M), Company may not own property in common with an Affiliated Wholesale Power Marketer.*

Vantage finds DE-Indiana is in compliance with Standard H. Vantage's analysis, findings and conclusions supporting its finding of compliance is discussed further in Chapter V.

Standard I:*No market information (within the meaning of the FERC's code of conduct requirements) obtained by Company in the conduct of its public utility business may be shared with an Affiliated Wholesale Power Marketer, except where such information has been publicly*

disseminated or simultaneously shared with and made available to all non-affiliated Entities who have requested such information. Customer specific information shall not be made available by Company to an Affiliated Wholesale Power Marketer 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.

Vantage finds DE-Indiana is in compliance with Standard I. Vantage's analysis, findings and conclusions supporting its finding of compliance is discussed further in Chapter V.

Standard J: *A Non-Utility Affiliate may use Company's name or logo only if, in connection with such use, the Non-Utility Affiliate makes adequate disclosures to the effect that: (i) the two Entities are separate; (ii) it is not necessary to purchase the Non-Regulated Goods or Services to obtain public utility service from Company; and (iii) the customer will gain no advantage from Company by buying from the Affiliate.*

Vantage finds DE-Indiana is in compliance with Standard J. Vantage's analysis, findings and conclusions supporting its finding of compliance is discussed further in Chapter V.

Standard K: *Company shall not condition or tie the provision of any Goods, Services, pricing benefit, or waiver of associated terms or conditions, to the purchase of any Goods or Services from an Affiliated Wholesale Power Marketer.*

Vantage finds DE-Indiana is in compliance with Standard K. Vantage's analysis, findings and conclusions supporting its finding of compliance is discussed further in Chapter V.

Standard L: *Except as provided in Standard (M) and to the maximum extent practical, employees responsible for directing, organizing and executing the business decisions of Affiliated Wholesale Power Marketers' wholesale merchant or generation functions - generally shall not share office space, office equipment, computer systems or information systems with those similarly employed employees of Company; provided, however, that computer systems and information systems may be so shared if the systems are secured such that Affiliated Wholesale Power Marketers cannot access Company operating data, and office space may be so 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.*

Vantage finds DE-Indiana is in compliance with Standard L. Vantage's analysis, findings and conclusions supporting its finding of compliance is discussed further in Chapter V.

Standard M:

1. *Computer systems and information systems may be shared between Company and Non-Utility Affiliates only to the extent necessary for the provision of corporate support services or other shared services; provided, however, Company shall ensure that the proper security access and other safeguards are in place to ensure full compliance with these Affiliate Standards.*
2. *These Affiliate Standards are not intended to, and shall not be interpreted to, preclude the sharing of computer systems and information systems between Company and its Affiliates as necessary for the provision of Services consistent with Service Agreements now or hereafter approved by the Commission, including, but not limited to, the Service*

Agreements identified as Petitioner's Exhibits I-1, I-2 and I-3 in Cause No. 42873 before the Commission.

Vantage finds DE-Indiana is in compliance with Standard M. Vantage's analysis, findings and conclusions supporting its finding of compliance is discussed further in Chapter V.

Standard N: *Company may engage in transactions directly related to the provision of corporate support services with its Affiliates in accordance with requirements relating to the Service Agreements. As a general principle, such provision of corporate support services shall not allow or provide a means for the transfer of confidential information from Company 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 these Affiliate Standards.*

Vantage finds DE-Indiana is in compliance with Standard N. Vantage's analysis, findings and conclusions supporting its finding of compliance is discussed further in Chapter V.

Standard O: *Except as provided in Standard (N), Company may only make Goods or Services available to an Affiliated Wholesale Power Marketer if the Goods or Services are equally available to all Non-Affiliated Wholesale Power Marketers on the same terms, conditions and prices, and at the same time. Company shall process all requests for Goods or Services from Affiliated and Non-Affiliated Wholesale Power Marketers on a non-discriminatory basis.*

Vantage finds DE-Indiana is in compliance with Standard O. Vantage's analysis, findings and conclusions supporting its finding of compliance is discussed further in Chapter V.

Standard P: *If Company provides both Regulated and Non-Regulated Services or Goods, or if an Affiliate provides Services or Goods to Company, Company and such Affiliate shall maintain documentation in the form of written agreements, an organization chart (depicting Company and all of its Affiliates), accounting bulletins, procedure and work order manuals, or other related documents, which describe how costs are allocated between Regulated and Non-Regulated Services or Goods. Such documentation shall be available, subject to requests for confidential treatment, for review by the Commission in accordance with Standard II. (B) of the Affiliate Standards.*

Vantage finds DE-Indiana is in compliance with Standard P. Vantage's analysis, findings and conclusions supporting its finding of compliance is discussed further in Chapter III.

Standard Q: *Company shall designate an employee who will act as a contact for the Commission and the OUCC seeking data and information regarding Company's Affiliate-related transactions and personnel transfers. Such employee shall be responsible for providing data and information requested by the Commission for any and all transactions between Company and its Affiliates, regardless of the Affiliate(s) from which the information is sought.*

Vantage finds DE-Indiana provides the required information to the IURC. However, the information is required to also be provided to the OUCC. Thus, DE-Indiana is not in compliance with Standard Q. Vantage's analysis, findings and conclusions supporting its finding is discussed further in Chapter VII.

Standard R: *Company shall designate an employee or agent who will act as a contact for the Commission concerning retail consumer issues regarding service and reliability concerns. Such Company representative shall be able to deal with billing, maintenance and service reliability issues.*

Vantage finds DE-Indiana provides the required information to the IURC. However, the information is required to also be provided to the OUCC. Thus, DE-Indiana is not in compliance with Standard R. Vantage's analysis, findings and conclusions supporting its finding is discussed further in Chapter VII.

Standard S: *Company shall provide the Commission a current list of employees or agents that are designated to work with the Commission and the OUCC concerning state regulatory matters, including, but not limited to, rate cases, consumer complaints and billing issues.*

Vantage finds DE-Indiana provides the required information to the IURC. However, the information is required to also be provided to the OUCC. Thus, DE-Indiana is not in compliance with Standard S. Vantage's analysis, findings and conclusions supporting its finding is discussed further in Chapter VII.

Standard T: *Any filings of Affiliate Contracts which the Company is required to make with the Commission, the SEC and/or the FERC shall be made consistent with the established procedures.*

Vantage finds DE-Indiana is in compliance with Standard T. Vantage's analysis, findings and conclusions supporting its finding of compliance is discussed further in Chapter VII.

Standard V: *Company shall fund the cost of four (4) independent audits (up to a total of \$400,000) after Merger consummation of Company's Affiliate-related transactions to determine compliance with these Affiliate Standards, and to determine that Company has sufficient controls and training in place to enable compliance with these Affiliate Standards. The results of such audits shall be filed with the Commission.*

Vantage finds DE-Indiana is in compliance with Standard V. Vantage's analysis, findings and conclusions supporting its finding of compliance is discussed further in Chapter VII.

Standard Z: *Company shall file with the Commission for the Commission's acceptance and approval any proposed purchase of firm power or unit power by Company from an Affiliate for a term of five (5) years or more.*

Vantage finds DE-Indiana is in compliance with Standard Z. Vantage's analysis, findings and conclusions supporting its finding of compliance is discussed further in Chapter VII.

Informational Filings: *Annual Informational Filings, Additional Annual Informational Filings and Special Informational Filings.*

Vantage finds DE-Indiana is in compliance with making its required Informational Filings in conformity with the regulatory requirements. Vantage's analysis, findings and conclusions supporting its finding of compliance is discussed further in Chapter VII.

Implementation of Previous Audit Recommendations - Recommendations from 2009 audit

covering the 2007 calendar year

Vantage finds that DE-Indiana has developed and implemented reasonable implementation plans with regard to each of the recommendations in the previous audit. Vantage's analysis, findings and conclusions supporting this finding are presented in Chapter VII.



III. IDENTIFICATION AND RECORDING OF AFFILIATE TRANSACTIONS

In this section, Vantage discusses its review of DE-Indiana's compliance with the Affiliate Standards that address the identification and recording of affiliate transactions. Written contracts between DE-Indiana and its affiliates were reviewed and a sample of transactions tested for compliance with applicable contract provisions.

A. BACKGROUND

Standard C of the Affiliate Standards requires that all transactions with affiliates be recorded in accordance with Generally Accepted Accounting Principles (GAAP) and that the records be maintained in sufficient detail to permit an audit of the affiliate transactions. In addition, all affiliate transactions and asset transfers must be accounted for in accordance with requirements of the Securities and Exchange Commission (SEC) or Federal Energy Regulatory Commission (FERC).

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

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

B. FINDINGS

Standard C

III-F1 DE-Indiana accurately accounts for affiliate transactions in accordance with regulatory requirements.

DE-Indiana complies with the Indiana Affiliate Standards by following the service request form process for the service agreements (Operating Companies Service Agreement, Operating Company/Non-utility Companies Service Agreement and Service Company Agreement) and the Asset Transfer Agreements. These agreements comply with relevant FERC requirements (Section 707) and, in certain cases, with more restrictive State requirements.²

^{2/} DR 3.47

FERC Order 707 requires that transfers of non-power goods or services between regulated franchised public utilities and their non-regulated utility or non-utility affiliates, be priced using asymmetrical pricing. Asymmetrical pricing requires that if the regulated utility transfers an asset or provides a service to a non-utility or non-regulated utility affiliate, the regulated utility must be paid the higher of cost or market. Conversely, if the non-regulated utility or non-utility transfers an asset or provides a service to the regulated utility, then the regulated utility pays the lower of cost or market. The asymmetrical pricing rules have not been applied to DE-Indiana's transactions for services with its non-utility affiliates under the Operating Company/Non-utility Companies Service Agreement because DE-Indiana was a party to this service agreement before March 30, 2008, (the effective date of Order 707).

Generally speaking, service transfers *to* DE-Indiana must be at fully embedded cost except for transfers from certain non-regulated utilities and Duke Energy Ohio Generation (DEO-Generation) which must be at the lower of cost or market. Service transfers *from* DE-Indiana must be at fully embedded cost except for transfers to DEO-Generation and other non-regulated utilities which must be at the higher of cost or market.

In addition to administrative and other services provided by the Service Company, DE-Indiana receives the following services from affiliates: boiler inspection; Combustion Turbine (CT) support services; hydro licensing; hydro outage support; operating model site assessment; and storm restoration. DE-Indiana provides: arc flash training; CT support services; lab services; storm restoration; technical assistance; and strike stop equipment installation & warehousing to affiliates.³

In 2009, DE-Indiana was provided services totaling approximately \$47,000 by two non-utility affiliates and totaling approximately \$34,187,000 by utility affiliates.⁴ In addition, DE-Indiana provided goods and services of approximately \$3,225,000 to affiliates in 2009, (both regulated and non-regulated affiliates).⁵ The Operating Agreement permits the regulated utility affiliates, DE-Carolinas, DE-Indiana, DE-Kentucky, DE-Ohio, and Miami Power to provide services to each other in such areas as: engineering and construction; operation and maintenance; installation; equipment testing; generation technical support; procurement; and environmental health and safety services. A utility may also lend employees to another utility so long as the loans do not interfere with the lending utility's operations. The Non-utility Agreement permits DE-Indiana to perform services such as engineering and equipment testing for non-utility affiliates. Non-utility affiliates may provide such services as: information technology services; meter reading; materials management; vegetation management; and marketing to DE-Indiana. The affiliates may lend employees as long as utility operations are not adversely affected.

³/ DR 1.3, Attachment A

⁴/ DR 5.55, Attachment A

⁵/ DR 5.54, Attachment A

Vantage reviewed supporting documentation for randomly selected sample affiliate transactions including transactions from the Service Company to DE-Indiana. The total monetary value of the transactions selected for review was approximately \$6.7 million. All transactions were found to be adequately supported and priced in accordance with relevant agreements.⁶

III-F2 DE-Indiana records all transactions with its affiliates in accordance with GAAP, and sufficient records are maintained to permit an audit of all transactions between DE-Indiana and its affiliates.

All affiliate transactions are processed in accordance with GAAP. A chart of accounts which is consistent with the FERC Uniform System of Accounts is utilized by DE-Indiana and its affiliates to record transactions. The Duke Energy policy for accounting for intercompany transactions requires that all intercompany transactions be recorded, that intercompany account balances be reconciled, and that discrepancies be resolved.⁷ All transactions incurred pursuant to the Operating Agreement, the Non-utility Agreement, and the Service Company Agreement, are separately reflected as intercompany charges through each party's payables and receivables accounts.

A service request form must be completed and approved whenever one of Duke Energy's regulated utilities provides services to any affiliate or receives services from any affiliate other than the service company. The estimated costs and subsequent actual charges must conform to the various service agreements and depending upon the situation, may require fully embedded costs or market costs.⁸

DE-Indiana retains supporting documentation for affiliate transactions. The Company provided copies of the relevant portions of the IURC record retention policy and its company record retention policy, respectively. The IURC requires that all records be preserved for at least three years, except as otherwise provided. The company record retention policy requires that journal entries and supporting detail be retained for 25 years or 6 years after a plant is retired or sold, whichever is greater.⁹

III-F3 A process has been developed to record and track asset transfers between the utility and non-utility affiliates.

Beginning in 2009, new procedures were promulgated which require that all capital asset transfers to or from a regulated utility affiliate and inventory transfers between regulated and non-utility affiliates or non-regulated utility affiliates be documented and approved on an affiliate asset transfer form. Capital asset transfers between regulated affiliates are at net book value. Transfers between the utility and either a non-regulated utility or non-utility

^{6/} DR 6.60

^{7/} DR 1.15, Attachment B

^{8/} DR 3.46, Attachment A

^{9/} DR 1.14

affiliate are priced at either the lower or higher of cost or market, pursuant to FERC Order 707.¹⁰

In 2009, the following capital assets were transferred (at net book value) between DE-Indiana and utility affiliates. The following is considered confidential and redacted.

[REDACTED]	[REDACTED]

The data supplied does not reflect transformers which were transferred during the fourth quarter of 2009 but not recorded due to a new system implementation. These fourth quarter transfers will be recorded in 2010 activity.¹¹ There were no transfers of capital assets between DE-Indiana and non-utility affiliates during 2009.¹²

Inventory items are treated as part of working capital and are not capitalized. When inventory items are issued to an affiliate, the items are transferred at average unit price which is considered a proxy for market price for items which have a high turnover rate. DE-Indiana applies the FERC asymmetrical pricing rules to sales of inventory items between DE-Indiana and a non-utility affiliate or non-regulated utility affiliate and adjusts transfer prices to market or "replacement value" when the average unit price does not reflect market price, (typically for items which have low turnover).¹³

III-F4 Recent Internal Audits associated with cost allocations and state affiliate standards provide recommendations for enhancements to the process.

Internal Audit #309015, dated October 30, 2009 addressed the allocations process.¹⁴ It evaluated the process and procedures for service companies and departmental allocations across Enterprise Transactions for the period of July 1, 2008 to June 30, 2009. The objectives were to determine whether:

- Processes and procedures were fully defined and roles and responsibilities were understood;

¹⁰/ DR 3.46, Attachment C

¹¹/ DR 6.63

¹²/ DR 6.61

¹³/ IR 10

¹⁴ / DR 2.43

- Allocations were consistently applied in compliance with applicable requirements;
- Cost pools were clearly defined and monitored.

The overall conclusion was that the process effectively administers allocations for the Enterprise. However, the process is complex and not fully understood by key business areas. There are opportunities for process enhancements which will impact the roles and responsibilities of process owners at the service company and departmental levels. Enhancements should include defining and communicating roles and responsibilities, implementing consistent documentation and monitoring practices, and providing training.

This moderate priority recommendation is scheduled for completion by August 31, 2010.

Internal Audit #110007, dated March 24, 2010 - FE&G State Affiliate Standards - Indiana and Kentucky. The scope of this audit was to assess compliance with Indiana and Kentucky Affiliate Standards. The audit focused on systems access, and controls and processes governing transactions between Duke Energy Indiana, Duke Energy Kentucky and respective affiliates. The objectives of the audit were to determine whether processes effectively ensure:

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

The conclusion of this moderate finding was that opportunities exist to enhance access reviews of regulated and non-regulated application data and improve the timeliness of corrections identified in the affiliate transaction review process.

Implementation will require changes to the GenWeb and MicroGads Gold user access and the FERC System Access Review system. Completion is expected in 2010.

C. RECOMMENDATIONS

III-R1 As part of the 2011 affiliate audit, provide details on fourth quarter 2009 transformer transfers. (Refer to Finding III-F3.)

DE-Indiana indicated that due to a new system implementation, quantification of the transformers transferred for the period of October 2009 to December 2009, could not be provided until the next audit cycle.

III-R2 Provide details on changes related to the two internal audits conducted. (Refer to Finding III-F2.)

Provide the next auditors with details of the changes made in response to the two internal audit reports discussed in Finding III-2 and the impact of the changes.

IV. FINANCIAL AND LIABILITY SEPARATION

A. INTRODUCTION

In this chapter, Vantage discusses its review of the sections of the standards that address financial liability and separation. This includes Standards D, E, F and P.

B. FINDINGS

Standard D- Financial and Liability Separation

The objective of Vantage's analysis for Standard D was to verify that DE-Indiana customers are adequately insulated from all existing and likely future liabilities of Duke Energy Corporation and its non-regulated subsidiaries. The purpose of the work in this area is to determine if the liabilities and financial obligations of Duke Energy Corporation and its affiliates remain separate from those of DE-Indiana. Our analysis includes a review of the adequacy of the Company's policies and procedures to financially separate a regulated public utility business from the parent company's other businesses, (particularly those that are non-regulated), in order to protect utility consumers from any bankruptcy or financial instability resulting from losses due to other market activities. Core principles that were addressed include the following.

- Any indebtedness incurred by another affiliate should be non-recourse to the utility.
- The utility may not enter into an agreement where it is obligated to commit funds in order to maintain the financial viability of another affiliate.
- The utility may not make any investment in another affiliate such that it would be liable for the debts and liabilities of that entity.
- The utility cannot issue any security for the purposes of financing the acquisition, ownership or operation of another affiliate.
- The utility cannot assume any obligation or liability of another affiliate as a guarantor, endorser, surety, or otherwise.
- The utility cannot pledge, mortgage or otherwise use as collateral any utility assets for the benefit of another regulated affiliate.

The work in this task area also entails a review of legacy Cinergy and Duke Power liabilities such as pension funding and environmental liabilities to ensure that the Company has in place policies and procedures for assuring that liabilities that should remain separate actually do so.

FINDINGS

IV-F1 Many of the historical issues regarding finance and indebtedness were addressed in the previous audit and have not changed significantly.

The previous report included a series of conclusions that addressed historical status of financing arrangements with Cinergy, Duke Energy and other affiliates. We summarize them here since we did not repeat this analysis.

1. The Cinergy non-utility affiliate and holding company indebtedness do not have recourse to DE-Indiana.
2. The company specifically attests to compliance with the Standard D restrictions regarding non-utility financial impacts on DE-Indiana.
3. The revolving credit agreements of Cinergy and Duke Energy and the Receivables Securitization Agreement have not negatively affected DE-Indiana.
4. DE-Indiana has complied with IURC restrictions on intercompany loans, with one minor exception. This issue deals with settling all of its intercompany balances on a monthly basis, as required by the intercompany service agreements.
5. DE-Indiana's credit ratings have improved due to a reduction in exposure to non-utility affiliate risks.
6. DE-Indiana is not affected by the pension and OPEB plans of other Duke Energy companies due to the maintenance of individual plans.

There were no recommendations in the last audit report regarding this topic.

IV-F2 DE-Indiana has only one subsidiary, South Construction Company (SCC), which provides support on property transactions.

SCC acts on behalf of DE-Indiana with respect to property transactions and its funding comes from DE-Indiana.

IV-F3 DE-Indiana has only two financial, operational, and other liability types (e.g. pension, environmental, energy trading), whose assignment among affiliates is possible.

Pension and OPEB

Both pension and OPEB liabilities are actuarially determined. For DE-Indiana, the liabilities reflected on the general ledger are calculated based on the plans that the Indiana employees participate in.¹⁵

Environmental Liabilities and Trading

Duke Energy and Cinergy have been active traders of electricity and natural gas through non-utility marketing and trading subsidiaries in the past. Duke Energy has greatly reduced its trading activities on the non-utility side. Duke Energy's non-utility trading book was previously traded in Houston, and transferred to Cinergy at the merger date. Cinergy eventually sold this trading business to Fortis. The DE-Carolinas trading operations for the utility business have not changed due to the Cinergy merger. DE-Carolinas, DE-Indiana and DE-Kentucky each have only one electric trading book, respectively. Each uses the CXL system for tracking its trades and the PACE system to allocate generation and purchased power costs between native load and non-native sales. All trades for native load are identified, and trades exceeding the native load are classified as wholesale sales and purchases. Prior to the merger, DE-Carolinas did not have large trading positions with Cinergy due to the distance between their primary areas of operation. Duke Energy Midwest (DE-Indiana, DE-Ohio, and DE-Kentucky) maintains trading books for its native utility loads in each of the Indiana, Ohio and Kentucky jurisdictions. The non-native trading positions of Ohio and a merchant trading book are operated jointly. According to DE-Carolinas, the trading operations of Cinergy and DE-Carolinas have been completely separate since the merger, and there have not been any transfer or sales of positions between these entities. Emissions allowances purchased, but not yet used, comprise common assets for power generators. Duke Energy reports that there have been no changes to the SO₂ emissions allowance assets of either entity resulting from the merger of Duke Energy and Cinergy. DENA transferred a small amount of NO_x allowances to DE-Ohio at the merger date. Liabilities are not recorded for the expected emissions allowances required by the generation entities, eliminating any potential for related liability transfer or sale.

IV-F4 DE-Indiana files a consolidated Federal Income Tax return and allocates in accordance with the Provisions of the Tax Sharing Agreement.

Duke Energy and its subsidiaries agreed to join annually in the filing of a consolidated Federal income tax return and to allocate the consolidated Federal income tax liabilities and benefits among the members of the consolidated group in accordance with the Provisions of the Tax Sharing Agreement. The Agreement provides generally that consolidated Federal, state and local income tax liabilities and benefits will be allocated, where appropriate,

¹⁵/ DR 1.19

among members by calculating each member's taxable income as if that member had filed a separate return on the same basis as used in the applicable consolidated return.

IV-F5 The policies and procedures associated with the Utility Money Pool Agreement and the management of short-term cash and working capital are well documented and comply with all merger conditions.

Duke Energy maintains an "Inter-company Funding Policy" that applies to DE-Indiana and all other regulated affiliates. This policy was issued on April 1, 2006 and revised on January 1, 2009. The statement and purpose of this document is to provide parameters around the activities that encompass cash consolidation. Corporate Treasury has the responsibility to ensure that in accordance with the "Corporate Cash Management Policy", cash assets are: i) properly safe-guarded; ii) managed to maximize value within approved investment parameters; iii) available to Corporate Treasury on a timely basis to fund general corporate needs; iv) not left idle and underutilized; and v) not unnecessarily exposed to the claims of lenders, other creditors, or unacceptable short-term cash investment risks. Corporate Treasury is also responsible and accountable for funding all expenditures that have been appropriately approved in accordance with the "Approval of Business Transactions Policy". This funding will often require the movement of cash between business entities in the form of Inter-company Cash Advances, Inter-company Loans, Equity Distributions and/or Inter-company Equity Investments.

Vantage reviewed the Accountability: Roles and Responsibilities as they apply to the Corporate or Business Unit. These roles and responsibilities required that:

- all Corporate and Business Unit personnel of the Enterprise shall ensure compliance with these guidelines;
- all Inter-company Funding Transactions must be approved in accordance with the Delegation of Authority;
- originator of the transaction must coordinate with Tax, Treasury, Accounting and Legal to determine the nature of funding (dividend or return of capital, equity contribution, cash advance or Inter-company loan);
- each Business Unit Controller, or his or her designee, will be responsible for tracking, servicing and accounting for their respective Inter-company Funding Transactions;
- notice of all Inter-company Funding Transactions, along with copies of any supporting documentation, should be provided upon closing to the associated Business Unit Controller's group and accounted for as appropriate for the type of transaction;
- all Inter-company Funding Transactions should be accounted for and periodically reviewed in accordance with the "Accounting for Inter-company Transactions Policy".

IV-F6 A process has been developed to apportion responsibility for Federal income tax liabilities and benefits among members of the Duke Energy consolidated group.

DE-Indiana participates in Duke Energy's Agreement for Filing Consolidated Income Tax Returns and for Allocation of Income Tax Liabilities and Benefits effective 2006 and for years following. This agreement generally provides that consolidated income tax liabilities and benefits are allocated to DE-Indiana and the other Duke Energy subsidiaries on the same basis as if each company had filed a separate income tax return on the same basis as used in the consolidated income tax return. Under this method, there is no impact for taxes to DE-Indiana customers from tax liabilities properly assignable to other affiliates.

Standards E and F

Standard E: Any untariffed, Non-Utility Services provided by Company or the Service Company to any Affiliate shall be itemized in accounting entries (including electronic entries) pursuant to a written contract or written arrangement. Company and the Service Company shall maintain and keep available for inspection by the Commission copies of all accounting entries and each contract and arrangement between Company or the Service Company and Company's Affiliates that relate to the provision of such untariffed, Non-Utility Services.

Standard F: Any Goods or Services provided by a Non-Utility Affiliate to Company shall be itemized in accounting entries (including electronic entries) pursuant to a written contract or written arrangement. Company and Non-Utility Affiliates shall maintain and keep available for inspection by the Commission copies of all accounting entries and each contract and arrangement between Company and its Non-Utility Affiliates that relate to the provision of such Goods and Services in accordance with the Commission's retention requirements.

IV-F7 Non-utility services provided by DE-Indiana or the Service Company to an affiliate, and goods and services provided to DE-Indiana by a non-regulated affiliate are covered by written agreements and are itemized in separate accounting entries.

The Service Company provides services to DE-Indiana under the Service Company Utility Service Agreement (Service Company Agreement). DE-Indiana and its utility affiliates provide goods and services to each other under the Operating Agreement. DE-Indiana provides utility-related goods and services to its non-utility affiliates under the Non-utility Agreement, and non-utility affiliates provide DE-Indiana with small amounts of goods and services under the same agreement.

DE-Indiana is also a party to certain other agreements filed with the IURC as part of its Annual Informational Filing.

- Tower Agreements.
- Utility Money Pool Agreement.
- Receivables Agreement.
- Joint Transmission System Planning and Operating Agreement.
- Water Supply Agreement.
- Tax Agreement.

Through 2009, the Service Company's approach for distributing costs not directly charged to an entity was to allocate such costs based on a series of data calculations which were updated annually. Included in these calculations was the general three-factor formula. In applying the three-factor formula, overhead costs for the Service Company did not allocate on the same basis as labor allocations. To reduce reliance on the general three-factor allocation formula, a new approach has been developed in 2010 whereby Service Company overhead will be applied to all Service Company labor charges, both directly charged and allocated labor costs. These charges will be offset by a credit back to overhead allocation pools on the Service Company, such that total dollars from the Service Company will not change.¹⁷ Vantage concurs with this new approach.

Standard P

IV-F8 DE-Indiana retains sufficient documentation that describes how costs are allocated between regulated and non-regulated services.

The Service Company provides services to DE-Indiana subject to the Service Company Agreement. DE-Indiana and its utility affiliates provide goods and services to each other subject to the Operating Agreement, and DE-Indiana provides utility-related goods and services to non-utility affiliates under the Non-utility Companies Service Agreement. DE-Indiana is required to maintain written documentation of the methods that costs are allocated between regulated and non-regulated services or goods.

The procedures and instructions regarding the use of work orders (both for services and assets) contain sufficient detail to explain the allocation methods.¹⁸In addition, the Service Company maintains and updates the various allocation factors for costs which are not directly assigned to affiliates. Finally, Duke Energy's "Accounting for Intercompany Transactions Policy" and the Company's annual information filing with the IURC provide general descriptions of the Company's methods for recording, settling and reconciling intercompany (including affiliate) transactions.

C. RECOMMENDATIONS

Vantage has no recommendations in this chapter.

¹⁷/ DR 8.65, Attachment A

¹⁸/ DR 6.58

V. AFFILIATE SEPARATION

A. INTRODUCTION

In this chapter, Vantage presents its analysis, findings and conclusions regarding DE-Indiana's compliance with Affiliate Standard provisions, (Standards G, H, I, J, K, L, M, N and O), regarding the adequate separation of the utility from its wholesale merchant and generation affiliates in the areas of physical space, information systems, employees, marketing activities, and the use of the company name and logo. Vantage has also presented its determination as to whether DE-Indiana has ensured comparable treatment of affiliates and third parties regarding access to customer information and availability of its goods and services.

B. FINDINGS

Standards G, H and L

V-F1 DE-Indiana is in compliance with Standards G, H and L, which require the separation of DE-Indiana's wholesale merchant and generation functions from the employees of affiliate wholesale power marketers, and that DE-Indiana does not own any property in common with affiliate wholesale power marketers.

In order to determine DE-Indiana's compliance with Standard G, it was necessary to verify that there is adequate separation of DE-Indiana's wholesale merchant and generation functions from the employees of affiliate wholesale power marketers. Through data requests and interviews, Vantage examined the separation of DE-Indiana's wholesale merchant and generation functions from the employees of affiliate wholesale power marketers.

First, the wholesale power marketing affiliates were identified.¹⁹ Other data requests inquired as to whether there was any space shared between DE-Indiana's wholesale merchant and generation functions and the employees of affiliate wholesale power marketers.²⁰ The responses confirmed that no space was shared or jointly-owned between the two groups and that corporate physical access guidelines for FERC-restricted areas required an electronic badge system for access to the area occupied by the DE-Indiana generation/transmission employees. The responses were verified through several interviews.²¹

Based on the responses and interviews, Vantage finds that DE-Indiana is in compliance with Standards G, H and L.

¹⁹/ DR 1.22

²⁰/ DR 1.25 and 1.26

²¹/ Interviews 3, 5, 9 and 13

Standards I, M and N

V-F2 DE-Indiana is in compliance with Standards I, M and N, which require that DE-Indiana not share market information about its regulated customers with affiliated wholesale power marketers, except for information that is also available to non-affiliated entities.

To determine compliance with Standard I M and N, relevant information systems were identified, policies and procedures governing sharing of information were examined and internal controls were reviewed to determine if they prevented the sharing of customer information.

In response to data requests, DE-Indiana provided a listing of shared information systems and the security measures used to assure against the continued confidentiality of the customer information.²²As a general rule, DE-Indiana follows the guidance of the FERC Code of Conduct/Standards of Conduct in sharing customer information. The FERC Code of Conduct prohibits the sharing of market information that includes customer information with a non-regulated utility unless simultaneously disclosed to the public. This information is provided to targeted employees through DE-Indiana's FERC Code of Conduct/Standards of Conduct computer-based training that is provided annually. The policies governing the sharing of customer information are also provided in the Indiana Affiliate Standards computer-based training.²³ In addition to the training, DE-Indiana was during the course of the audit in the process of developing formal guidelines governing the release of confidential information. It is Vantage's understanding that the guidelines have been completed and are available to employees via a share drive.

In addition to a list of shared information systems, DE-Indiana included the names of the "gatekeepers" for each of the systems. Two of the "gatekeepers" were interviewed to discuss the process utilized to assure the inadvertent sharing of confidential information.²⁴The interviews confirmed that the shared systems have firewall separation and that separate passwords are required for regulated users and non-regulated users. Employees requesting system access are required to submit a request for access via eform/email to the system administrator "gatekeeper" through the employee's manager. Both the manager and the system administrator must approve the request prior to granting access to the appropriate system. In order to maintain access on an on-going basis, DE-Indiana relies on a compliance tool called "Open Pages". This tool is used to remind the administrators to complete a review of system access on at least an annual basis or sometimes more frequently. The system also advises the administrator of employee

²²/ DRs 1.27, 1.29 and 4.49

²³/ Interview 13

²⁴/ DR 1.29 and Interviews 14 and 15

transfers that require the change in the employee's access to the information in order to delete access on a timely basis.

Based on its analysis, review of responses to data requests and interviews, Vantage finds that DE-Indiana is in compliance with Standard I, M and N.

Standard J

V-F3 During 2009, there was no use by any non-utility affiliate of the DE-Indiana logo and therefore DE-Indiana is in compliance with Standard J.

DE-Indiana's responses to data requests demonstrated that it has appropriate policies and procedures in place as well as specific details how to use the corporate logo but that no non-utility affiliate used the logo during 2009.²⁵ Accordingly, Vantage finds DE-Indiana in compliance with Standard J.

Standard K

V-F4 During 2009, no DE-Indiana customer had entered a contract with an affiliated wholesale provider that included a tying arrangement and therefore DE-Indiana is in compliance with Standard K.

DE-Indiana's response to data request confirmed that no DE-Indiana customer has a contract with an affiliated wholesale provider that includes a tying arrangement.²⁶ Based on the response, Vantage finds that DE-Indiana is in compliance with Standard K.

Standard O

V-F5 During 2009, DE-Indiana did not provide any products or services to any affiliated wholesale power marketer or other third party marketer and therefore DE-Indiana is in compliance with Standard O.

Based on DE-Indiana response to data requests and interviews with DE-Indiana employees, it was confirmed that DE-Indiana had not provided any products and services to any affiliated wholesale power marketer or other third party.²⁷ Therefore, Vantage concludes that DE-Indiana is in compliance with Standard O.

C. RECOMMENDATIONS

There were no recommendations in this chapter.

²⁵/ DRs 1.24 and 4.51

²⁶/ DR 1.28

²⁷/ DR 1.30 and Interviews 9 and 12

VI. CONTROLS AND TRAINING

A.BACKGROUND

In this chapter, Vantage presents the results of its analysis and review relative to the adequacy of the internal controls and training that DE-Indiana has in place to ensure compliance with the Affiliate Standards. Compliance with the Affiliate Standards is actually achieved through DE-Indiana's own self-enforcement of the standards. This self-enforcement is accomplished through internal controls and training programs. In Chapters III and V the internal controls and processes that DE-Indiana has implemented to protect the confidentiality of consumer information, to prevent the unintended sharing of information with non-utility affiliates, as well as to appropriately allocate costs are discussed and found to be in compliance. Accordingly, this chapter focuses on training.

B.FINDINGS

BACKGROUND

Adequate and appropriate training is a crucial ingredient to DE-Indiana's plan to comply with the Affiliate Standards. Since compliance relies heavily on an employee's ability to identify potential violations, the employees must be informed about the standards and the importance of compliance. To accomplish this DE-Indiana relies on primarily two different training programs: Indiana Affiliate Training (both classroom and computer-based training) and 2009 FERC Code/Standards of Conduct Training (Condensed version and longer version).

VI-F1 While the DE-Indiana's Indiana Affiliate Training and 2009 FERC Code/Standards of Conduct Training adequately identify and explain the compliance standards, they are very simplistic with few examples.

In response to data requests, DE-Indiana provided copies of the Indiana Affiliate Training and the 2009 FERC Code/Standards of Conduct Training.²⁸ The training packages were carefully reviewed and checked to make certain they adequately addressed all of the relevant standards. However, our review of these training programs found them to be very mundane and basically a straight-forward recitation of the standards with a few simplistic examples. This is a concern because this training will be repeated annually for the affected employees. It would be advisable to develop a more interesting and invigorating way to present these standards and keep the employees interested.

VI-F2 The DE-Indiana Code of Business Ethics training program is outstanding.

Every new hire at DE-Indiana takes the Code of Business Ethics New Hire Training course. Employees then take a computer-based refresher course on an annual basis. During the

²⁸ / DRs 1.27 and 1.32

audit, Vantage reviewed the New Hire Training course, the 2009 Code of Business Ethics Refresher course and the 2010 Code of Business Ethics Refresher course.²⁹Vantage found the courses to be outstanding. They were viable, interesting and thought provoking. The employees were presented with realistic examples that had to be carefully thought through in order to satisfactorily resolve the business ethics issue. Some of the examples involved affiliate standard issues. It would be most unlikely that an employee would be bored while taking this interactive, computer-based training.

VI-F3 DE-Indiana's process to make certain that the appropriate employees take the necessary training is not as formal as it could be.

The selection of which employees were to receive the Indiana Affiliate training was based on the role, responsibility and function of the employee. For the initial training employees who have responsibility for affiliate standards requirements (merger conditions) as well as employees impacted by the affiliate standards were selected.³⁰A compliance software tool called "Open Pages" is used to track which employees have taken the course and to send reminders to those employees that need to take the course.³¹Although DE-Indiana's compliance with the Affiliate Standards is an important issue for the Company, there are no written policies or procedures clearly stating which employees are required to take the Indiana Affiliate training, setting deadlines for completing the course or detailing how to deal with those employees who delayed taking the training. In response to one of Vantage's data requests, DE-Indiana provided a list of the employees who had taken the course.³²However the list also identified approximately 25 employees who had been sent two reminders to take the course but still had not done so. During an interview with one of DE-Indiana's compliance personnel, it became clear that there were no definite plans of when to remind these employees again or when to alert the employees' supervisors to prod the employee to take the course.³³

C. RECOMMENDATIONS

VI-R1 Enhance affiliate training with more realistic examples that encourage the employee to think through the affiliate issue presented.

The Code of Business Ethics training has established a standard to which DE-Indiana should strive to reach with its Indiana Affiliate training. The current Indiana Affiliate training meets the minimum requirements through a mundane presentation of the affiliate standards and some trivial examples. The annual review of this material as currently presented will

²⁹/ DR 5.53

³⁰/ DR 1.33

³¹/ DR 1.35

³² / DR 1.27

³³ / IR 13

only be a necessity for the employees and likely be viewed as having little value. The training would be much more effective if it were enlivened with better examples and a more interactive presentation of the standards.

VI-R2 Implement a set of formal procedures surrounding the provision of its Indiana Affiliate training.

In response to the issue that arose during the interview and through a follow-up data request, a draft of the training protocol currently under development by the Ethics and Compliance Department was provided.³⁴ The draft protocol establishes who the intended audience for the training is, when and how the training is offered, when the training should be updated, when reminders should be sent including reminders to immediate supervisors, and the maintenance of training records. The response indicated that the current plan is to implement the training protocol by the first quarter of 2011. Vantage recommends that this protocol for the Indiana Affiliate training be established no later than the planned date.

³⁴ / DR 4.50

VII. DESIGNATIONS AND FILING REQUIREMENTS

A. BACKGROUND

Another important component of compliance is demonstrating compliance to those directly involved in the regulation of the utility. This chapter will review how DE-Indiana keeps the IURC and/or the OUCC advised of its compliance. The relevant affiliate standards that are reviewed in this chapter are Standards Q, R, S, T and Z. In addition, Vantage reports on its review of DE-Indiana's Annual Informational Filing. Finally, Vantage reports on DE-Indiana's efforts to implement recommendations from the previous audit of its compliance with the Affiliate Standards.

B. FINDINGS

Standard Q, R and S

VII-F1 DE-Indiana partially complies with Standards Q, R and S which require DE-Indiana to designate contacts regarding affiliate matters, service and reliability concerns and state regulatory matters for the IURC. However, the information should also be provided to the OUCC.

DE-Indiana has clearly identified employee contacts for the IURC.³⁵ The letter to the IURC that DE-Indiana provided in response to our data request identifies the contact, the issues they are responsible for and the phone number to reach the contact. However, Standards Q, R and S require that the information also be provided to the OUCC. Therefore, Vantage finds DE-Indiana is not in complete compliance with Standards Q, R and S.

Standards T and Z

VII-F2 DE-Indiana complies with Standards T and Z which require DE-Indiana to conform to established procedures when filing contracts related to affiliate matters or the purchase of firm or unit power from and affiliate.

During the audit period of 2009, DE-Indiana did not file any affiliate contracts with FERC or SEC.³⁶ During the audit period, DE-Indiana did file the Duke Energy Indiana Utility and Non-utility Asset Transfer Agreement and Intercompany Asset Transfer Agreement. In a letter dated June 12, 2009 the IURC accepted the agreements.

³⁵/ DR 1.36

³⁶/ DR 1.38

In response to a data request, DE-Indiana attests that DE-Indiana did not enter into any contract with an affiliate for the purchase of firm or unit power for a term of five or more years.³⁷

Accordingly, Vantage finds DE-Indiana in compliance with Standards T and Z.

Annual Informational Filings

VII-F3 DE-Indiana's Annual Informational Filings meet all of the established compliance requirements.

The Annual Informational Filing must include the following.

- Business and financial information on each DE-Indiana affiliate.
- An assessment of how the activities of each affiliate might affect DE-Indiana's capital structure and its ability to attract capital in the future.
- A description of how transfers are identified valued and recorded.
- A description of methods used to allocate tax expense, payments and refunds.
- A description of specific transfers of assets, goods or services during the period, including the transfer value.
- A description of transfers of personnel during the period, including the transfer value.
- The names and job descriptions of DE-Indiana employees transferred to an affiliate and those who allocated 75% or more of their time to an affiliate.
- Any amendments to the Utility Money Pool Agreement.
- Any transfers by DE-Indiana to a non-utility affiliate of confidential information or intellectual property, whose original cost exceeds \$500,000.

Vantage carefully reviewed DE-Indiana's most recent Annual Informational Filing.³⁸ Our review found that DE-Indiana complied with all of the filing requirements. All of the required information was clearly identified and presented.

^{37/} DR 1.39

^{38/} DR 1.37

VII-F4 DE-Indiana's Rates and Legal Departments have implemented a reasonable procedure for the preparation of the Annual Informational Filing.

To provide assurance and continuity in the Annual Informational Filing, the Rates and Legal Departments have prepared a written set of procedures and quality control steps for the preparation of the report.³⁹The procedures specify the filing requirements and assign responsibility for the collection of the information. The procedures were reviewed with the Rates and Legal personnel and Vantage believes the procedures will provide assurance that the annual filings are prepared consistently and timely.⁴⁰

Standard V

VII-F5 DE-Indiana complies with Standard V that requires DE-Indiana to fund four independent audits of its compliance with the Affiliate Standards.

This audit is the second audit of DE-Indiana's compliance with the Affiliate Standards. At this time, Vantage has no reason to believe that DE-Indiana would not comply with Standard V and fund the remaining two audits.

VII-F6 DE-Indiana, in response to the first audit, has prepared reasonable plans to implement each of the recommendations made in the audit.

With the exception of the recommendation to develop a cost allocation manual, DE-Indiana has developed and implemented reasonable responses to each of the recommendations in the previous audit.⁴¹ The following recommendations, from the first Liberty Consulting Audit, and responses by DE-Indiana are excerpted from September 01, 2009 filing in Case No. 42873 (comments by Vantage in italics).

Liberty Recommendation 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.

Response: The Settling Parties agree that Duke Energy Indiana will develop and implement a process to record and manage transfers between utility and non-utility affiliates on or before November 30, 2009.

Vantage has confirmed that the Affiliate Asset Transfer procedure is in place. In addition DE-Indiana has implemented an online eForm application and trained all relevant employees on how to use the eForm to track asset transfers between regulated and non-regulated or non-utility affiliates (or vice-versa) affiliates and capital asset transfers between all affiliates.

³⁹/ DR 1.42, Attachment A

⁴⁰/ IRs 1 and 2

⁴¹/ DR 1.42

Transfer of Duke Energy Indiana Power Delivery and Generation capital assets (regulated utility affiliate to regulated utility affiliate) are transferred at net book value. Transfer of Power Production capital assets (regulated utility affiliate to non-regulated utility affiliate or non- utility affiliate) are recorded based upon the "Pricing Guide for Affiliate Transactions", pursuant to FERC Order 707. These transfers will record either at the lower or higher of cost or market (per FERC and state requirements).

Liberty Recommendation 2: Initiate a comprehensive program to comply with standards Land Mof the Affiliate Standards.

Response: The Settling Parties agree that Duke Energy Indiana will develop and implement a comprehensive program to develop a process to comply with standards L and M, which address the sharing of office space, office equipment, computer systems or information systems with affiliated wholesale power marketers, on or before November 30, 2009.

Vantage verified that Duke Energy Indiana has developed a confidential System Inventory listing all Duke Energy applications identifying the owner of that application and establishing a process for tracking and documenting access.

Liberty Recommendation 3: Develop and maintain a formal affiliate transaction accounting manual, similar to a cost allocation manual (CAM) required in other jurisdictions.

Response: The Settling Parties agree that Duke Energy Indiana's existing Annual Affiliate Informational Filing provides sufficiently similar data and information as a "cost allocation manual" and therefore agree that a CAM is not needed at this time.

Vantage agrees that the current Indiana requirement is satisfied through this response.

Liberty Recommendation 4: Initiate a comprehensive program that will start Duke Energy Indiana on a path to compliance with Standard V and the Affiliate Standards.

Response: Compliance with Standard V includes funding the cost of four audits to determine compliance and to determine whether Duke Energy Indiana has sufficient controls and training in place to ensure compliance with the Affiliate Standards. As is evidenced by the filing of the Audit Report on June 9, 2009, Duke Energy has honored its commitment as to the funding of the first audit. However, the Audit Report concluded that Duke Energy Indiana "had no specific programs or activities whose purpose is compliance with Standard V and the Affiliate Standards." *Audit Report*, p. 49. The Settling Parties agree that Duke Energy Indiana will develop and implement training around the affiliate standards. Implementation will begin on or before November 30, 2009.

Duke Energy Indiana has developed and implemented classroom training of the affiliate standards and will conduct four training sessions for relevant employees before the end of the 2009 calendar year (November 19, December 9 (two sessions), and December 10). Additionally, an on-line version of the affiliate standards training is in the process of being developed and will be deployed prior to the end of calendar year 2009 for annual training.

Further, this audit is evidence that DE-Indiana is complying with the requirement to conduct annual audits.

Liberty Recommendation 5: Correct the errors in the Informational Filings, and institute a quality control process for assuring accurate reporting.

Response: The Settling Parties agreed that Duke Energy Indiana will submit a corrected informational filing. Furthermore, the Settling Parties agree that Duke Energy Indiana will institute a quality control process for assuring accurate reporting to be completed on or before November 30, 2009.

Vantage is satisfied, based on its review of documentation, that a reasonable effort has been undertaken to correct errors.

C. RECOMMENDATIONS

VIVII-R1 Provide contact information to the OUCC per Standards Q, R and S.

As discussed above, DE-Indiana provides the IURC with the contact information required by Standards Q, R and S. However, the Standards also require that the information be provided to the OUCC. In the future, DE-Indiana should provide the information not only to the IURC but also the OUCC.