139 FERC ¶ 61,114
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Philip D. Moeller, John R. Norris,
and Cheryl A. LaFleur.

Louisville Gas and Electric Company and Kentucky Utilities Company — Docket No. EL12-27-000

ORDER GRANTING PETITION FOR DECLARATORY ORDER

(Issued May 14, 2012)

1. On February 14, 2012, Louisville Gas and Electric Company (LG&E) and Kentucky Utilities Company (KU) (together, Applicants) filed a petition for declaratory order requesting the Commission to find that their proposed payment of dividends from equity accounts will not violate section 305(a) of the Federal Power Act (FPA).[1] For the reasons stated below, we will grant Applicants' petition for declaratory order.

**Background**

2. On October 25, 2010, the Commission approved the acquisition by PPL Corporation (PPL) of E.ON U.S. LLC, the parent company of LG&E and KU, from E.ON AG.[2] In connection with that transaction, E.ON U.S. LLC was renamed LG&E and KU Energy LLC (LKE). LKE, which is now a wholly-owned subsidiary of PPL, continues to own LG&E and KU.

3. Applicants state that under generally accepted accounting principles (GAAP), LG&E and KU were required to adopt purchase accounting in connection with the acquisition, with the result that the purchase price paid by PPL be allocated to the acquired assets and liabilities based on their fair values. Applicants explain that under GAAP, if the purchase price paid by the acquiring company exceeds the fair value of the acquired companies' identifiable net assets, the excess is recorded as goodwill on the acquiring company's balance sheets. This goodwill must then be reviewed to determine whether it must be assigned, or "pushed down," to the balance sheet of the acquired entity or any of the acquired entity's subsidiaries.

[1] 16 U.S.C. § 825d(a) (2006).

[2] *PPL Corp.*, 133 FERC ¶ 61,083 (2010).

4. Applicants state that PPL determined after closing the acquisition that it was required to apply push-down accounting to each of LKE, LG&E and KU. Applicants indicate that application of push-down accounting to LG&E and KU resulted in one-time adjustments to their assets and liabilities and an elimination of the retained earnings of each company. According to Applicants, the amount of retained earnings eliminated by the adjustment following the acquisition was approximately $809 million for LG&E and $1.418 million for KU. Prior to the adjustment, these retained earnings were recorded in Account No. 216, Unappropriated Retained Earnings, and Account No. 216.1, Unappropriated Undistributed Subsidiary Earnings. Applicants state that there was no overall impact on the companies' equity from the adjustment, as LG&E and KU recorded a corresponding increase in Account No. 211, Miscellaneous Paid-in Capital. Applicants state that the adjustments were recorded on separate purchase accounting ledgers for LG&E and KU to ensure the activity can be tracked and there will be no impact on the calculation of rates charged to customers.

5. Applicants explain that subsequent to the application of push-down accounting, goodwill must be tested for impairment at least annually.[3] Applicants further explain that when a goodwill impairment charge becomes necessary, and when amortization or impairments of other net assets created in push-down accounting occur, the impairment charge and amortization reduce income, thereby reducing retained earnings. Applicants state that push-down accounting resulted in LG&E and KU recording goodwill and other net assets of $389 million and $614 million, respectively.

6. Applicants state that since the acquisition of LKE by PPL, both LG&E and KU have had positive retained earnings and have limited dividends to their parent, LKE, to approximately 65 percent of earnings. Applicants further state that, as of September 30, 2011, LG&E had $66 million of retained earnings and KU had $90 million of retained earnings available to pay future dividends. Applicants explain that, had push-down accounting not been applied to the acquisition of LKE, LG&E's adjusted retained earnings balance at September 30, 2011, would be $875 million and KU's adjusted retained earnings balance as of the same date would be $1,508 million. Applicants assert that these are the appropriate balances available for the payment of future dividends to LKE by LG&E and KU, respectively. Applicants state that both LG&E and KU plan to continue to pay approximately 65 percent of earnings from the prior fiscal quarter to LKE in the future, although that may vary based on specific capital needs and cash flow considerations and as needed to maintain an appropriate capital structure. Applicants further state that, although the amount of dividends to be declared is expected to be well below the balances in LG&E's and KU's retained earnings immediately prior to PPL's acquisition of LKE, the application of push-down accounting has substantially reduced LG&E's and KU's retained earnings accounts, with the result that any significant

[3] Impairment of goodwill occurs when the book value of the goodwill exceeds its fair value. When impaired, the book value of goodwill is decreased to its fair value.

impairment of goodwill or period of poor performance could deplete existing retained earnings, potentially leaving them unable to pay dividends.

7. Accordingly, Applicants request that the Commission issue an order finding that they will not violate FPA section 305(a) if they pay dividends from equity accounts that represent adjusted retained earnings. Applicants state that "adjusted retained earnings" would be defined as: (a) the amount in each Applicant's retained earnings account immediately prior to the closing of PPL's acquisition of LKE; plus (b) cumulative "adjusted net income," representing cumulative post-acquisition reported net income excluding the impact of impairments and amortization of push-down accounting net assets, net liabilities and goodwill impairments; less (c) cumulative post-acquisition dividends. Applicants note that the Commission recently granted similar requests from Duke Energy Ohio, Inc,[4] and has also made similar rulings in other merger-related proceedings.[5]

8. In support of their request, Applicants make three representations.[6] First, they state that the source of the dividends is clearly identified. Applicants state that dividends will be paid from their equity accounts, including capital and retained earnings accounts representative of what each Applicant's retained earnings would have been absent push-down accounting. Applicants state that the application of push-down accounting had no effect on their cash flow available to fund investments and pay dividends.

9. Second, Applicants state that the dividends will not be excessive and will not impair their ability to conduct utility operations. Applicants state that they do not expect to pay more dividends than they would have been able to pay absent the acquisition. Additionally, the actual funds used to pay the dividends will be the same – only the accounts used will be different. Applicants note that their dividend payments since the acquisition have been consistent with payments made beforehand.

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[4] *See Cincinnati Gas and Electric Co., d/b/a Duke Energy Ohio*, 115 FERC ¶ 61,250 (2006); *Duke Energy Ohio, Inc.*, 137 FERC ¶ 61,137 (2011).

[5] Applicants Petition for Declaratory Order at 13 (citing *Exelon Generation Company, LLC*, 114 FERC ¶ 61,317 (2006) (permitting the electric utility subsidiaries involved in the Exelon-PSEG Merger to issue dividends up to the amount of their pre-merger retained earnings accounts); *Exelon Corp*., 109 FERC ¶ 61,172 (2004) (authorizing payment of dividends from capital accounts in connection with the Unicom-PECO merger); *Niagara Mohawk Holdings, Inc*., 95 FERC ¶ 61,381 (2001) and *Niagara Mohawk Holdings, Inc.*, 99 FERC ¶ 61,323 (2002) (conditionally approving the payment of dividends out of paid-in capital accounts following the National Grid-Niagara Mohawk merger where application of purchasing accounting depleted the retained earnings account); *New England Power Co*., 89 FERC ¶ 61,266 (1999) (same)).

[6] *Id.* at 11 (citing *Citizens Utilities Co.*, 84 FERC ¶ 61,158, at 61,864 (1998)).

10. Finally, Applicants state that the issuance of dividends will not harm shareholders. Each Applicant will have the same shareholder (LKE) before and after the dividends are paid. Additionally, each Applicant commits to cease payment of dividends if its adjusted retained earnings were to fall to $0, or if the payment of dividends would result in its adjusted equity falling below 30 percent of total capital, where adjusted equity represents reported equity, adjusted to remove the effects of the push-down of purchase accounting.

**Notice of Filing**

11. Notice of Applicants' filing was published in the *Federal Register*, 77 Fed. Reg. 11,529 (2012), with interventions or protests due on or before March 15, 2012. None was filed.

**Discussion**

12. We will grant Applicants' petition. Section 305(a) of the FPA provides that:

> It shall be unlawful for any officer or director of any public utility to receive for his own benefit, directly or indirectly, any money or thing of value in respect of the negotiation, hypothecation, or sale by such public utility of any security issued or to be issued by such public utility, or to share in any of the proceeds thereof, or to participate in the making or paying of any dividends of such public utility from any funds properly included in capital accounts.[7]

The reasons underlying the enactment of section 305(a) included a concern "that sources from which cash dividends were paid were not clearly identified and that holding companies had been paying out excessive dividends on the securities of their operating companies."[8] A key concern, thus, was "corporate officials raiding corporate coffers for their personal financial benefit."[9]

13. Those concerns do not apply here. As noted above, Applicants have clearly identified the source from which dividends will be paid. The dividends will be paid from equity accounts and will not exceed LG&E's and KU's adjusted retained earnings. Additionally, we find that it is appropriate for Applicants to remove the effects of

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[7] 16 U.S.C. § 825d(a) (2006).

[8] *Citizens Utilities Co.*, 84 FERC ¶ 61,158, at 61,865.

[9] *Id.* (citing *Safe Harbor Water Power Corporation*, 5 FPC 221, 237, *reh'g denied*, 5 FPC 1015 (1946), *aff'd*, 179 F.2d 179 (3d Cir. 1949), *cert. denied*, 339 U.S. 957 (1950)).

push-down accounting in determining the funds available to pay dividends. Here, LG&E and KU will not be paying more dividends than they would have been able to pay absent the application of push-down accounting associated with PPL's acquisition of LKE. The only difference is the accounts from which the dividends will be made.

14. Finally, the payment of dividends from equity accounts will not harm shareholders. LG&E and KU will have the same shareholder (LKE) both before and after the dividends are paid. We note that Applicants have made a commitment in support of their petition for declaratory order to cease paying dividends out of capital accounts if their respective adjusted retained earnings fall to $0 or if such payments result in adjusted equity falling below 30 percent of total capital, and our determination here is based upon Applicants' compliance with that commitment.[10]

15. Based on the facts and circumstances presented by Applicants, we will grant the petition and accordingly find that section 305(a) of the FPA is not a bar to Applicants' payment of dividends from equity accounts as described above.

The Commission orders:

(A) Applicants' petition for declaratory order is hereby granted, as discussed in the body of this order.

(B) Applicants must inform the Commission of any change in circumstances that would reflect a departure from the facts the Commission relied upon in granting the petition.

By the Commission.

( S E A L )

Kimberly D. Bose,
Secretary.

[10] Applicants Petition for Declaratory Order at 12.