137 FERC ¶ 61,137
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Duke Energy Ohio, Inc. Docket No. EL11-58-000

ORDER CONDITIONALLY GRANTING PETITION FOR DECLARATORY ORDER

(Issued November 17, 2011)

1. On August 5, 2011, Duke Energy Ohio, Inc. (Duke Energy Ohio) filed a petition for declaratory order requesting the Commission to find that its 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, as conditioned below, Duke Energy Ohio's petition for declaratory order.

Background

2. The Commission approved the merger of Cinergy Corp. (Cinergy) and Duke Energy Corporation (Duke Energy) on December 20, 2005.[2] The merger closed on April 3, 2006. As a result of the merger, Cinergy became wholly owned by Duke Energy. Cinergy retained its wholly-owned subsidiary, Cincinnati Gas & Electric Company, which was renamed Duke Energy Ohio, the petitioner.

3. Duke Energy Ohio states that under generally accepted accounting principles (GAAP), mergers resulting in a change of control must be accounted for by using the purchase method of accounting. Under this accounting method, the merger of Duke Energy and Cinergy is treated as an acquisition of one company by another. The purchase price paid for the acquired company is allocated to the acquired assets and liabilities based on their fair values. If the acquiring company's purchase price exceeds the fair value of the acquired company's identifiable net assets, the excess is recorded as

[1] 16 U.S.C. § 825d(a) (2006).

[2] *Duke Energy Corp.*, 113 FERC ¶ 61,297 (2005).

goodwill on the acquiring company's balance sheets. The goodwill, and any other corresponding adjustments to the values of assets and liabilities of the acquired entity, must be reviewed to determine whether it must be then assigned or "pushed down" to the balance sheets of the acquired entity or any of the acquired entity's subsidiaries (push-down accounting).

4. Duke Energy states that it determined that it needed to apply push-down accounting to Duke Energy Ohio. This resulted in Duke Energy Ohio recording goodwill and a one-time adjustment to certain of its asset and liability accounts together with an offsetting increase to its capital accounts of $2,894 million. Duke Energy Ohio also reset its retained earnings accounts to zero by transferring approximately $671 million to its capital accounts.[3]

5. To ensure that it could continue to pay dividends to its shareholders, Duke Energy Ohio sought a declaratory order in Docket No. EL06-66-000, requesting that the Commission find that the payment of dividends from its capital accounts up to the amount in its retained earnings account immediately prior to the merger (capital account) did not violate section 305(a). The Commission granted Duke Energy Ohio's request.[4]

6. The Commission's order granting Duke Energy Ohio's previous request under section 305(a) addressed the effect of resetting its retained earnings to zero. In its current petition, Duke Energy Ohio states that the use of push-down accounting has had a second potential effect on its ability to pay dividends after the merger. This second effect derives from the fact that push-down accounting resulted in a significant amount of goodwill and other increases to net assets recorded on the books of Duke Energy Ohio ($2,894 million). Duke Energy Ohio explains that, since the merger, it has analyzed goodwill for impairment under GAAP, and it has reduced the amount of goodwill recorded on its books. In addition, the other increases to net assets recorded on Duke Energy Ohio's books as a result of push-down accounting have been amortized over time or impaired in accordance with GAAP. These non-cash amortization and impairment charges, in turn, reduced Duke Energy Ohio's net income and its account for retained earnings. Accordingly**,** Duke Energy Ohio argues that a disconnect exists between the capital account increased by push-down accounting and the retained earnings account reduced by subsequent impairment charges and amortization of push-down accounting amounts. Duke Energy Ohio represents that goodwill impairment and amortization of push-down accounting amounts have reduced the retained earnings account by $1,691 million as of

---

[3] Immediately prior to the closing, Duke Energy Ohio's retained earnings account was approximately $671 million.

[4] *Cincinnati Gas and Electric Co.*, 115 FERC ¶ 61,250 (2006).

March 2011, thereby potentially bringing into question the extent to which it can continue to make dividend payments.

7. Duke Energy Ohio states that as of March 31, 2011, it had $340 million remaining in its capital account available to pay future dividends to Cinergy. However, it believes that the appropriate balance available to pay future dividends to Cinergy as of March 31, 2011 should be $1,258 million, which reflects the amount that would have been in retained earnings as of March 31, 2011 had push-down accounting not been recorded.

8. Duke Energy Ohio expects to make further dividends in the future in accordance with its dividend policies. Depending on the circumstances, the amount of dividends to be declared may exceed the retained earnings account at the time, even though there would have been adequate amounts in the retained earnings account but for the effects of push-down accounting.

9. Duke Energy Ohio states that prior to the closing of the merger, its retained earnings were recorded in Account 216 – Unappropriated Retained Earnings. At the time of the merger closing, those amounts were transferred to Account 211 – Miscellaneous Paid-in Capital. In order to track the extent to which dividends could be made from this account, the amount of retained earnings transferred into Account 211 were recorded in a separate sub-account of Account 211. Duke Energy Ohio proposes also to track in a separate sub-account of Account 211 the amount of post-merger net losses attributable to impairments and to amortization of push-down accounting net assets attributable to the merger. As dividends are paid in the future that are in excess of the amounts in Duke Energy Ohio’s retained earnings accounts at the time of the dividend, the applicable sub-accounts in Account 211 will be reduced correspondingly, until the applicable sub-accounts are reduced to zero. At that time, Duke Energy Ohio will stop paying dividends from its capital accounts. It will disclose in a note to its FERC Form 1 financial statements the balances in these sub-accounts as of the end of each year.

10. Duke Energy Ohio requests that the Commission issue an order declaring that it will not violate section 305(a) if it pays dividends from its equity accounts that represent “adjusted retained earnings,” defined for these purposes to mean: (a) Duke Energy Ohio’s retained earnings immediately before the merger ($671 million), plus (b) cumulative “adjusted net income,” representing cumulative post-merger net income excluding the impacts of impairments and amortization of push-down accounting net assets and goodwill impairments, less (c) cumulative post-merger dividends. Duke Energy Ohio states that the effect of the Commission’s order would be to allow payment of dividends from equity accounts for the amount of retained earnings had push-down accounting not been in effect, i.e., $1,258 million as of March 31, 2011. In support of this request, Duke Energy Ohio makes three representations.

11. First, Duke Energy Ohio states the source of the dividends is clearly identified. Dividends will be paid from Duke Energy Ohio's equity accounts, including capital and retained earnings accounts, representative of what Duke Energy Ohio's retained earnings would have been absent push-down accounting (i.e., dividends will not exceed adjusted retained earnings). Duke Energy Ohio explains that the push-down of purchase accounting adjustments from the merger had no effect on its cash flows available to fund investments and to pay dividends.

12. Second, Duke Energy Ohio states that the dividends will not be excessive and will not impair its ability to conduct utility operations. Duke Energy Ohio states that it will not be paying more dividends than it would have been able to pay but for the merger. In addition, Duke Energy Ohio states that the funds it will use to pay the dividends are no different after the closing of the merger than before. The only difference is the accounts from which the dividends will be paid.

13. Finally, Duke Energy Ohio states that the payment of dividends from equity accounts representing adjusted retained earnings will not harm shareholders. Duke Energy Ohio will have the same shareholders both before and after the dividends are issued. Dividends will be made consistent with Duke Energy Ohio's capital structure targets, which are designed to maintain credit metrics to support investment grade ratings. In addition, Duke Energy Ohio states that it would cease the payment of dividends if adjusted retained earnings fell to $0, or if the payment of dividends would result in "adjusted equity" (representing reported equity, as adjusted to remove the effects of the push-down of purchase accounting) falling below 30 percent of total capital.

<u>Notice of Filing</u>

14. Notice of Duke Energy Ohio's filing was published in the *Federal Register*, 76 Fed. Reg. 50,211 (2011), with interventions or protests due on or before September 6, 2011. None was filed.

<u>Discussion</u>

15. We will grant, as conditioned below, Duke Energy Ohio's petition.

16. Section 305(a) provides that:

> It shall be unlawful for any officer or director of any public utility to receive for his own benefit, directly or indirectly, any money or thing of value in respect of the negotiation, hypothecation, or sale by 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.[5]

The concerns 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."[6] A key concern, thus, was "corporate officials raiding corporate coffers for their personal financial benefit."[7] The record in this case justifies no such concerns.

17. As noted above, Duke Energy Ohio has clearly identified the source from which dividends will be paid. The dividends will be paid from equity accounts and will not exceed Duke Energy Ohio's adjusted retained earnings. Additionally, we find that it is appropriate for Duke Energy Ohio to remove the effects of push down accounting in determining the funds available to pay dividends. Here, Duke Energy Ohio will not be paying more dividends than it would have been able to pay absent the push down accounting associated with the merger. The only difference is the account from which the dividends will be made. In this regard, we note that Duke Energy Ohio has made a commitment in support of its petition for declaratory order to cease paying dividends out of capital accounts if its adjusted retained earnings fall to $0 or if such payments result in adjusted equity falling below 30 percent of its total capital, and we condition our determination here on Duke Energy Ohio complying with its commitment.[8]

18. Finally, the payment of dividends from equity accounts will not harm shareholders. Duke Energy Ohio will have the same shareholders both before and after the dividends are paid. The dividends will be paid consistent with Duke Energy Ohio's capital structure targets, which are designed to maintain credit metrics to support investment grade ratings.

19. Based on the facts and circumstances presented by Duke Energy Ohio, we will grant the petition, as conditioned above, and accordingly find that section 305(a) of the

---

[5] 16 U.S.C. § 825d(a) (2006).

[6] *E.g.*, *Citizens Utilities Co.*, 84 FERC ¶ 61,158, at 61,865 (1998); *Delmarva Power & Light Co.*, 91 FERC ¶ 61,043, at 61,158-59 (2000); *PPL Electric Utilities Corp.*, 99 FERC ¶ 61,317, at 62,356-57 (2002).

[7] *Id.*

[8] Duke Energy Ohio Aug. 5, 2011 Petition for Declaratory Order, Docket No. EL11-58-000, at 9.

FPA is not a bar to Duke Energy Ohio's payment of dividends from certain equity accounts as described above.

The Commission orders:

(A) Duke Energy Ohio's petition for declaratory order is hereby conditionally granted, as discussed in the body of this order.

(B) Duke Energy Ohio 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. Commissioner Spitzer is not participating.

(S E A L)

Kimberly D. Bose,
Secretary.