

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF KENTUCKY)	
UTILITIES COMPANY FOR AN ORDER)	
AUTHORIZING THE ISSUANCE OF)	CASE NO. 2003-00059
SECURITIES AND THE ASSUMPTION)	
OF OBLIGATIONS)	

O R D E R

On February 14, 2003, Kentucky Utilities Company (KU) filed an application for authority to obtain up to \$250 million in long-term debt financing from an affiliate within the E.ON AG (E.ON) registered holding company system. KU plans to use the proceeds to (1) refinance \$62 million in First Mortgage Bonds maturing on June 15, 2003; (2) finance \$70 million as part of the acquisition cost of four combustion turbines;¹ and (3) fund up to \$125 million of its 2001 Amended Pollution Control Compliance Plan costs.² KU made a motion for an informal conference with Commission Staff. However, since the relief sought by KU has essentially been granted by this Order, the Commission finds that the issue is moot and that the motion should be denied.

¹ Case No. 2002-00381, Application of Louisville Gas and Electric Company and Kentucky Utilities Company for a Certificate of Public Convenience and Necessity for the Acquisition of Four Combustion Turbines and A Site Compatibility Certificate for the Facility, Order dated March 18, 2003.

² Case No. 2000-00112, Application of Kentucky Utilities Company and Louisville Gas and Electric Company for a Certificate of Public Convenience and Necessity to Construct Selective Catalytic Reduction (SCR) NOx Control Technology, Order dated June 22, 2000 and Case No. 2000-00439, Application of Kentucky Utilities Company for Approval of an Amended Compliance Plan for Purposes of Recovering the Costs of New and Additional Pollution Control Facilities and to Amend its Environmental Cost Recovery Surcharge Tariff, Order dated April 18, 2001.

KU plans to borrow the money from Fidelia Corporation (Fidelia), a subsidiary of E.ON North America, which is a subsidiary of E.ON, KU s parent company. KU stated that it will not borrow from Fidelia unless the interest rate will be equal to or lower than the cost of borrowing from E.ON or the capital markets. If the money is borrowed from Fidelia, the rate will be at the lowest of (1) E.ON s effective cost of capital; (2) Fidelia s effective cost of capital; or (3) KU s effective cost of capital measured in comparison to the effective cost of KU borrowing from an independent third party.³ KU refers to this as the Best Rate Method, which it stated will assure that it will not pay more for a loan from Fidelia than it would pay in the capital markets for a similar loan. KU also stated that it intends to issue fixed rate bonds.⁴ In previous financing cases, KU has often indicated that it would choose a variable rate in conjunction with interest rate hedging agreements. If a variable rate option is chosen for the bonds issued herein, the Commission finds that KU should also enter into rate hedging agreements in order to protect its ratepayers from interest rate fluctuations.

KU later stated, however, that the interest rate on its borrowing from Fidelia will be the lower of (1) the average of three quotes obtained from international investment banks for an unsecured bond issued by E.ON with the applicable term of the loan; and (2) the average of three quotes obtained from international investment banks for a first mortgage bond with the applicable term of the loan. KU further stated that it anticipates that Fidelia will match the lowest rate.⁵

³ Application at 3 and Exhibit 3 Loan and Security Agreement page 4.

⁴ March 21, 2003 Response to Item 1(a) of Commission Staff s Initial Data Request Dated March 11, 2003 (Staff s Initial Request).

⁵ March 21, 2003 Response to Item 2 of Staff s Initial Request.

The Commission finds that KU has not adequately explained why the use of an average interest rate rather than the use of the lowest interest rate is reasonable. The use of an average interest rate, as described in KU's data response, does not comport with the loan agreement in the application. The Best Rate Method implies that quotes will be obtained in order to determine the lowest rate, not an average rate. Since the Securities and Exchange Commission's approval of the E.ON financing does not endorse or define a specific method to determine the interest rate, the Commission finds that borrowing from Fidelia should result in KU's receiving the lowest rate available, rather than an average of interest rates.⁶ The Commission does not object to KU and Fidelia securing multiple quotes to document the market conditions at the time it secures the loan, but sees no reason why the quotes obtained by KU should be used to determine an average interest rate rather than the lowest rate.

The Commission, having considered the evidence of record and being otherwise sufficiently advised, finds that the proposed issuance of securities and the assumption of obligations in connection therewith as set out in KU's application is for lawful objects within the corporate purposes of KU's utility operations, is necessary and appropriate for and consistent with the proper performance of its service to the public, will not impair its ability to perform that service, is reasonably necessary and appropriate for such purposes, and should therefore be approved.

IT IS THEREFORE ORDERED that:

1. KU is authorized to obtain long-term debt from Fidelia in an aggregate amount not to exceed \$250,000,000, as set forth in its application.

⁶ March 21, 2003 Response to Item 7 of Staff's Initial Request.

2. KU's proposal to use an average interest rate for this long-term financing is denied.

3. KU shall obtain an interest rate from Fidelity that is no greater than the lowest available rate that KU may obtain from any other source.

4. KU is authorized to execute, deliver, and perform its obligations under the loan agreements with Fidelity.

5. The proceeds from the transactions authorized herein shall be used only for the lawful purposes set out in the application.

6. KU shall agree only to such terms and prices that are consistent with this order and that produce the lowest cost financing.

7. KU shall, within 30 days from the date of issuance, file with this Commission a statement setting forth the date or dates of issuance of the securities authorized herein, the price paid, the interest rate, and all fees and expenses, including underwriting discounts or commissions or other compensation, involved in the issuance and distribution. KU shall also file documentation showing the quotes that it relied upon to determine the lowest interest rate.

8. KU's motion for an informal conference is denied as moot.

Nothing contained herein shall be construed as a finding of value for any purpose or as a warranty on the part of the Commonwealth of Kentucky or any agency thereof as to the securities authorized herein.

Done at Frankfort, Kentucky, this 14th day of April, 2003.

By the Commission

ATTEST:


Executive Director