COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF THE UNION LIGHT, HEAT AND POWER COMPANY FOR AN ORDER AUTHORIZING THE ISSUANCE OF FIRST MORTGAGE BONDS, UNSECURED DEBT, AND LONG-TERM NOTES, ISSUANCE OF INTER-COMPANY PROMISSORY NOTES, EXECUTION AND DELIVERY OF LONG-TERM LOAN AGREEMENTS, AND USE OF INTEREST RATE MANAGEMENT INSTRUMENTS	)	CASE NO. 2005-00027

O R D E R

On January 12, 2005, The Union Light, Heat and Power Company ("ULH&P") filed its application for authority to establish a financing program of up to $900 million[1] that includes the issuance of first mortgage bonds and debentures (together "the securities"), execution, delivery, or assumption of various loan agreements related to the issuance of tax-exempt bonds, issuance of inter-company unsecured promissory notes, the use of interest rate management instruments, and entrance into all necessary agreements and other documents relating thereto. On March 7, 2005, ULH&P amended its application, requesting in addition to the authority requested in its January 12, 2005 application, that the Commission authorize the assumption by ULH&P of debt

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[1] The $900 million amount is the sum of the requested authorities; however, the different authorities will be interchangeable so that the total amount financed will be something less than $900 million. As ULH&P's response to Item 4(a) of the First Data Request of Commission Staff dated February 10, 2005, states "The $900 million is not an aggregate amount per se, but rather the sum of the requested authorities for each type of financing. For example, if a $200 million inter-company note is utilized to partially finance the initial transfer of assets, it is anticipated that such note would be replaced with long-term financing using bonds when market conditions are favorable for such replacement."

of The Cincinnati Gas & Electric Company ("CG&E").[2] ULH&P states in its amended application that it has determined that management and mitigation of certain tax issues may be facilitated by the assumption of CG&E debt rather than the issuance of inter-company notes or debt.

Proceeds from the financing program are to be used to acquire certain generating assets from CG&E, the acquisition of which was preliminarily approved by the Commission in Case No. 2003-00252,[3] and for other general lawful purposes arising from the ongoing general financing needs of ULH&P. On April 1, 2005, ULH&P expects to add property related to the acquisition of generating assets of approximately $371.6 million. ULH&P proposes to issue and sell, over a period of time ending December 31, 2006, up to an aggregate principal amount of $500,000,000 in securities or unregistered unsecured long-term notes. ULH&P also proposes to enter into, over a period ending December 31, 2006, one or more long-term loan agreements by which it would borrow from issuers of tax-exempt bonds a maximum aggregate principal amount of $200 million for terms not to exceed 40 years. In connection with the generation acquisition, ULH&P proposes to issue one or more inter-company promissory notes, or assume debt of CG&E as the transferor of the generating assets, up to an aggregate principal

[2] The original application requested authority for ULH&P to assume tax exempt debt associated with the assets to be transferred to ULH&P. The amended application requests the additional authority for ULH&P to assume debt of CG&E in regard to the generation acquisition without regard to whether the debt is taxable or tax-exempt.

[3] Case No. 2003-00252, The Application of The Union Light, Heat and Power Company for a Certificate of Public Convenience and Necessity to Acquire Certain Generation Resources and Related Property; for Approval of Certain Purchase Power Agreements; for Approval of Certain Accounting Treatment; and for Approval of Deviation from Requirements of KRS 278.2207 and 278.2213(6), Order dated December 5, 2003.

amount of $200 million. ULH&P also requests authority to enter into interest rate management instruments to manage its overall effective interest cost.

Securities

ULH&P proposes certain parameters under which the securities are to be sold. These parameters, set forth in Exhibit A of the application, are designed to provide a reasonable allowance for potential changes in market conditions between the time of the Commission's authorization and the actual sale of the securities. Included in the parameters is a requirement that the interest rate is not to exceed those rates generally available at the time of pricing or re-pricing the bonds or unsecured indebtedness for securities having the same or reasonably similar maturities and having reasonably similar terms, conditions and features as securities issued by utility companies or holding companies of the same or reasonably comparable credit quality.

In Case No. 2001-00439,[4] the Commission expressed concern about ULH&P's request for market-based limits for its proposed securities. However, noting ULH&P's contention that the establishment of interest rate ceilings could result in missed opportunities in the capital markets and have negative impacts on its ability to operate, the Commission allowed such market-based rates. Our Order required, however, upon the issuance of securities, that ULH&P notify the Commission of the interest rate alternative selected for the issue. ULH&P was required to provide a detailed explanation as to how the alternative chosen represented the most reasonable interest

[4] Case No. 2001-00439, The Application of The Union Light, Heat and Power Company For An Order Authorizing the (I) Issuance and Sale of Up To $75,000,000 Principal Amount of First Mortgage Bonds or Unsecured Debt And (II) Use of Interest Rate Management Techniques, Order dated March 22, 2002 at 2.

rate available at the time of issuance. The explanation was to include a description of the specific interest rate management techniques and interest rate management agreements utilized by ULH&P for each issuance. ULH&P was also required to file copies of any interest rate management agreements executed in conjunction with the issuance.

For the current proposed securities, the Commission will allow ULH&P to continue to utilize market-based limits on interest rates. We will also require the same notification and reporting requirements as set forth in our Order in Case No. 2001-00439, as outlined herein.

Long-Term Notes

Long-term notes will be issued under terms and conditions similar to the securities. The notes will have a maturity of not less than two years and may bear interest at either a fixed or variable rate. Similar to the securities, the long-term notes are subject to market-based rates. The Commission will, therefore, require the same notification and reporting requirements for the issuance of long-term notes as required herein for the issuance of securities.

Inter-Company Promissory Notes/Assumption of Debt

ULH&P proposes to issue one or more inter-company promissory notes to CG&E, or to assume certain indebtedness of CG&E in connection with the generation acquisition and in situations when it is the most economical form of financing. The portion of the inter-company promissory notes related to specific projects at the East Bend generating station, which qualify for tax-exempt financing, will bear an interest rate equal to the all-in weighted average cost of the specific underlying tax-exempt issuances applicable to East Bend. All other inter-company promissory notes will bear an interest rate equal to the all-in weighted average cost of imbedded long-term debt (excluding tax-exempt debt) of CG&E, including the coupon interest rate plus any additional costs associated with amortization of finance charges and debt discounts associated with outstanding issuances of CG&E. The promissory notes related to the generation acquisition will be prepayable, in whole or in part, at any time prior to the scheduled maturity, without penalty or premium. ULH&P states that equivalent financing could not be found in today's market at a cost below the inter-company promissory notes.

In its amended application, ULH&P proposes to assume debt of CG&E as an alternative to, or in combination with, the issuance of inter-company promissory notes. Upon the assumption of the debt, ULH&P would become responsible for payment of principal and interest and the other obligations set forth in the loan documentation of the debt assumed.

Loan Agreements

ULH&P proposes to borrow from various issuers, the proceeds from the issuance of tax exempt bonds. ULH&P will enter into loan agreements with the issuers of tax exempt bonds to evidence and secure its obligations to repay the loans. ULH&P also proposes certain parameters under which loan agreements can be executed, which are set forth in Exhibit C of the application. ULH&P proposes, if tax-exempt bonds bear interest that is subject to adjustment, that the bond will also contain a requirement that will allow the interest rate to be fixed under certain circumstances. Proceeds from the long-term loans will be used to finance or reimburse the costs of acquiring and constructing solid waste facilities and other environmental control facilities. ULH&P expects that the interest rate on the issuer's tax-exempt bonds will be less than the interest rate that it would be able to obtain on taxable bonds that it could issue in the capital markets.

Interest Rate Management Instruments

In order to have sufficient alternatives and flexibility to better manage its interest cost, ULH&P requests authority to enter into interest rate management instruments. In Case No. 2001-00439, the Commission granted ULH&P similar authority. Interest rate swaps, caps, collars, floors, options or hedging instruments such as forwards or futures, or similar products could be used to manage interest costs. Pricing parameters in connection with any interest rate management agreement will be governed by the parameters corresponding to the underlying obligation in effect at its original issuance. Net fees and commissions will be in addition to those parameters and will not exceed 10 percent of the amount of the underlying obligation.

SUMMARY

ULH&P intends to use the proceeds from the securities, long-term notes, inter-company promissory notes, debt assumptions, and loan agreements to: (1) repay a portion of its short-term indebtedness, (2) redeem early portions of its long-term debt, (3) fund estimated future construction expenditures of $86 million in 2005 and $75 million in 2006 related to its gas delivery and electric generation, transmission and distribution businesses,[5] (4) acquire generating assets from CG&E, and (5) fund additional expenditures as contemplated by KRS 278.300.

FINDINGS AND ORDERS

The Commission, having considered the evidence of record and being otherwise sufficiently advised, finds that the issuance and sale by ULH&P of securities, long-term notes, inter-company promissory notes, debt assumptions and loan agreements as set forth in its application are for lawful objects within its corporate purposes, are necessary and appropriate for and consistent with the proper performance of its service to the public, are reasonably necessary and appropriate for such purposes, and should therefore be approved. However, approval herein of the requested financing should in no way be considered final approval of the acquisition of the generating assets described and preliminarily approved in Case No. 2003-00252.

IT IS THEREFORE ORDERED that:

1. ULH&P is authorized to issue and sell up to $500 million of its first mortgage bonds or unsecured indebtedness in one or more transactions through December 31, 2006.

2. ULH&P is authorized to issue a long-term, inter-company promissory note or notes, or assume debt of CG&E as the transferor of generation assets, in an aggregate principal amount of up to $200 million, as partial payment of its generation acquisition, when it is the most economical form of financing for ULH&P.

[5] Construction cost estimates do not include expenditures relating to generating asset acquisition.

3. ULH&P is authorized to execute and deliver over a period of time ending December 31, 2006, one or more long-term loan agreements by which it would borrow, from authorized issuers of tax-exempt bonds for terms not to exceed 40 years, the proceeds of up to a maximum aggregate principal amount of $200 million of the authorized issuer's tax exempt bonds.

4 ULH&P is authorized to enter into such interest rate management instruments as needed to manage its interest costs on its financial obligations.

5. ULH&P shall, within 10 days after each issuance of the securities, or long-term notes referred to herein, file with the Commission a statement setting forth the date or dates of issuance, the price paid, the interest rate, the purchasers, and all fees and expenses, including underwriting discounts or commission or other compensation, involved in the issuance. In addition, ULH&P shall include a detailed explanation as to how the interest rate alternative chosen represents the most reasonable interest rate available at the time of issuance. The explanation shall include a description of the specific interest rate management techniques and interest rate management agreements utilized by ULH&P for each issuance, as well as copies of any executed interest rate management agreements.

6. ULH&P shall, within 10 days after each issuance of the inter-company promissory notes, or loan agreements referred to herein, file with the Commission a copy of any executed promissory note or loan agreement.

7. ULH&P shall, within 10 days after each assumption of CG&E debt, file with the Commission a copy of the debt assumption agreement between ULH&P and

CG&E. In addition, ULH&P shall include a detailed explanation of why it chose to assume existing debt of CG&E, rather than issue new long-term, inter-company notes.

8. ULH&P shall agree only to such terms and prices that are consistent with the parameters set out in its application.

9. The proceeds from the transactions authorized herein shall be used only for the lawful purposes set out in the application. ULH&P shall, within 10 days after each issuance of the financing instruments referred to herein, file with the Commission a statement setting forth the use of the proceeds from the issuance.

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 13th day of April, 2005.

By the Commission

ATTEST:

Executive Director