

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF BIG RIVERS ELECTRIC CORPORATION FOR APPROVAL TO ISSUE EVIDENCES OF INDEBTEDNESS	)	CASE NO.
	)	2009-00441
	)	

O R D E R

On November 13, 2009, Big Rivers Electric Corporation (“Big Rivers”) tendered its application seeking Commission approval to supplement or terminate certain existing evidences of indebtedness and issue new evidences of indebtedness in connection with refunding, by redemption, \$83,300,000 in County of Ohio, Kentucky (“Ohio County”), Pollution Control Refunding Revenue Bonds, Series 2001A Periodic Auction Reset Securities (“2001A Bonds”)<sup>1</sup> and the issuance by Ohio County of a like amount of Pollution Control Refunding Revenue Bonds, Series 2010A (“2010A Bonds”).

Big Rivers is an electric generation and transmission cooperative organized under KRS Chapter 279 which owns electric generation and transmission facilities and purchases, transmits, and sells electricity at wholesale. It exists for the primary purpose of supplying the wholesale electricity requirements of its three distribution cooperative members, Kenergy Corp., Meade County Rural Electric Cooperative Corporation, and Jackson Purchase Energy Corporation (“Members”). Its Members provide retail electric service to approximately 112,000 retail members in 22 Western Kentucky counties.

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<sup>1</sup> Case No. 2001-00102, Big Rivers Electric Corporation’s Application for Approval to Amend and Issue Evidences of Indebtedness (Ky. PSC Jun. 18, 2001).

A procedural schedule was established for this case which provided for two rounds of discovery on Big Rivers, intervenor testimony, and one round of discovery on the intervenors. Alcan Primary Products Corporation and Century Aluminum of Kentucky General Partnership (“Intervenors”) requested and were granted intervention. Commission Staff issued two data requests to Big Rivers. The intervenors issued no data requests.

On February 11, 2009, Big Rivers and the Intervenors submitted a stipulation which stated that the Intervenors would not file testimony, that the matter was ready to be submitted on the record for decision by the Commission, and that Big Rivers sought a final Order in this matter by no later than April 1, 2010.

#### BACKGROUND

Big Rivers financed construction of the pollution control facilities at its Wilson Generating Station, in part, with the proceeds from the \$83,300,000 Variable Rate Demand Pollution Control Refunding Bonds, Series 1985 (“1985 Bonds”).<sup>2</sup> The outstanding principal amount of the 1985 Bonds was refunded by redemption in 2001 through the issuance by Ohio County of the 2001A Bonds.

The 2001A Bonds, which mature October 1, 2022, are auction rate securities, which bear interest at rates that are reset periodically through open market auctions. With respect to the 2001A Bonds, investors can seek to liquidate these securities every 28 days. In recent years, the market for auction rate securities has experienced

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<sup>2</sup> Big Rivers Electric Corporation’s Application to Amend the November 13, 1980 Order Issued in Case No. 7990 by Authorizing Big Rivers Electric Corporation’s Borrowing of Proceeds of up to \$83,300,000 County of Ohio, Kentucky Variable Rate Demand Pollution Control Refunding Bonds, Series 1985 and Execution of Documents Evidencing Such Debt, Case No. 9448.

problems causing such securities, including the 2001A Bonds, to bear interest, at times, at their maximum rates. The 2001A Bonds' maximum interest rate is 18 percent.

### PROPOSED INDEBTEDNESS

#### Primary Evidences of Indebtedness

Big Rivers proposes to refund the 2001A Bonds through Ohio County's issuance of the 2010A Bonds. The 2001A Bonds will be called for redemption, the proceeds of the 2010A Bonds will be used to pay the principal of the 2001A Bonds due on the redemption date, and certain funds of Big Rivers will be used to pay the interest due on the 2001A Bonds through the redemption date.<sup>3</sup> In connection with the foregoing, Big Rivers also seeks to issue the following evidences of indebtedness.

The first evidence of Indebtedness is the "2010 Loan Agreement" between Ohio County and Big Rivers under which Ohio County will loan Big Rivers the entire amount of the 2010A Bonds in order to pay off the 2001A Bonds. Big Rivers will repay the new loan by paying all debt service on the 2010A Bonds to maturity. The 2010 Loan Agreement provides for a maturity date for the 2010A Bonds of no later than August 31, 2031. The interest rate on the 2010A Bonds will be fixed to maturity at the time they are sold. Based on information provided to Big Rivers by the 2010A Bonds' underwriter, Goldman, Sachs & Co. ("Goldman Sachs"), Big Rivers estimated, based on a maturity date of August 31, 2031 and market conditions at the time the estimates were made, that the interest rate on the 2010A Bonds would be between 6.75 and 7.25 percent, assuming Big Rivers' credit is unenhanced. The 2010A Bonds will be subject to an optional redemption call after 10 years.

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<sup>3</sup> Big Rivers' estimated up-front cost associated with refunding the 2001A Bonds and issuance of the 2010A Bonds is \$1.635 million.

Big Rivers will issue its First Mortgage Note, Series 2010A ("2010A Note"), in the name of the trustee for the 2010A Bonds, U.S. Bank National Association ("2010A Bond Trustee"), in an amount equal to the \$83.3 million aggregate principal amount of the 2010A Bonds. The 2010A Note will have a maturity date, interest rate and terms which will match those of the 2010A Bonds, and payments thereon will be used to pay all debt service on the 2010A Bonds.

The 2010A Note will be issued and secured under the First Supplemental Indenture ("Supplemental Indenture") to the July 1, 2009 Indenture between Big Rivers and U. S. Bank National Association, as Trustee.

#### Supplemental Evidences of Indebtedness

The cost to Big Rivers of the 2010A Bonds may be reduced if its credit is enhanced. The means selected by Big Rivers to enhance its credit is a guaranty ("Guaranty") of the principal and interest payments on the 2010A Bonds to the 2010A Bond Trustee, with such Guaranty being provided by the National Rural Utilities Cooperative Finance Corporation ("CFC"). Based on the bond market at the time of Big Rivers' application, Goldman Sachs estimated that such a Guaranty could result in a net present value savings of approximately \$3.3 million over the life of the 2010A Bonds compared to their being priced based solely on Big Rivers' credit. This savings would lower the net effective interest rate on the 2010A Bonds to a range of 6.4 to 6.9 percent.

Such a Guaranty will require that Big Rivers issue a note and other agreements, which are in the nature of evidences of indebtedness. Big Rivers will use the Guaranty and enter into various other arrangements in connection with the marketing of the 2010A Bonds if use of the Guaranty results in an economic benefit in the pricing and

interest rate on the 2010A Bonds. Big Rivers will make this determination on or about the time the 2010A Bonds are sold. These other arrangements are described below.

1. The "Reimbursement Agreement" between Big Rivers and CFC relating to the Guaranty will address the fees related to the Guaranty and Big Rivers' repayment obligations in the event CFC is called upon to make any payments under the Guaranty. The Guaranty will be structured as follows: At least one business day prior to any payment date of principal and/or interest on the 2010A Bonds, the 2010A Bond Trustee will notify CFC if there are insufficient funds available to make said payment. CFC will then send funds to the 2010A Bond Trustee in the amount of any insufficiency in order to pay bondholders. CFC will be subrogated to the rights of the bondholders, and the amounts of principal and/or interest due and owing on such date will become obligations of Big Rivers to CFC. The Reimbursement Agreement will be issued only if the Guaranty results in an economic benefit in the pricing and interest rate on the 2010A Bonds as determined by Big Rivers on or about the time the 2010A Bonds are sold.

2. CFC will require that Big Rivers purchase \$11,903,570 in interest-bearing equity certificates in CFC ("Equity Certificates"). This amount is equal to 14.29 percent of the principal amount of the 2010A Bonds issued by Ohio County and guaranteed by CFC. The Equity Certificates will amortize on the same basis and over the same term as the principal required to be repaid on the 2010A Bonds. The Equity Certificates will yield a return to Big Rivers pursuant to applicable CFC policies.

3. Big Rivers proposes to enter into an Equity Loan Agreement with CFC ("CFC Loan Agreement"), under which it will obtain an unsecured term loan from CFC ("CFC Loan") to purchase the Equity Certificates. The CFC Loan will be evidenced by

an unsecured note from Big Rivers to CFC ("CFC Note") matching the term of the 2010A Bonds, with other terms fixed on the loan advance date at CFC's standard interest rates and terms for unsecured term loans as described in the CFC Loan Agreement. The interest rate applicable at the time of Big Rivers' application would be between 7.0 and 7.5 percent. Big Rivers will issue the CFC Loan Agreement and CFC Note only if the Guaranty results in an economic benefit in the pricing and interest rate on the 2010A Bonds as determined on or about the time the 2010A Bonds are sold.

4. There are certain costs under the Guaranty for which Big Rivers will be responsible. Under Section 2.02(a) of the Reimbursement Agreement, Big Rivers will owe an annual, non-refundable fee equal to 0.35 percent of the aggregate principal amount of the 2010A Bonds outstanding. At \$83.3 million, the annual fee would be \$291,550. Big Rivers will also owe interest on the principal balance of the CFC Note. These costs will be mitigated by interest earned on the Equity Certificates. Big Rivers estimates that its net cost of interest paid on the CFC Note and interest earned on the Equity Certificates will be 0.16 percent of the aggregate principal amount of the 2010A Bonds outstanding, or \$133,280. The resulting total estimated annual cost to Big Rivers of the Guaranty is \$424,830. This cost will be offset by an estimated annual bond interest savings of \$708,050, resulting in an estimated annual benefit of \$283,220.

5. Big Rivers will incur a one-time estimated expense of \$105,000 to cover CFC's expenses related to documenting and approving the Guaranty arrangements, whether or not Big Rivers determines to implement the Guaranty. Big Rivers will not elect to use the Guaranty arrangements unless the present value cost to Big Rivers of

the 2010A Bonds with the Guaranty is less than the present value cost to Big Rivers of the 2010A Bonds without the Guaranty.

### DISCUSSION

Big Rivers states that it seeks to refund the 2001A Bonds primarily to eliminate its exposure to uncertain costs of debt service on the 2001A Bonds resulting from the recent turmoil in financial markets and the specific uncertainties associated with the auction rate securities market. Big Rivers states that it would have sought to refund the 2001A Bonds to reduce the costs and risks of that debt at an earlier date, but its financial condition prior to the July 16, 2009 closing of the “unwind transaction” made such refunding nearly impossible. With the closing of the unwind transaction, however, Big Rivers states that it has obtained three investment grade credit ratings.

According to Big Rivers, the refunding of the 2001A Bonds and issuance of the 2010A Bonds with no credit support from Ambac Assurance Corporation<sup>4</sup> will also eliminate the exposure it had to Ambac for certain fees set out in the July 16, 2009 letter agreement between Big Rivers and Ambac,<sup>5</sup> that Ambac required as consideration for its consent to the unwind transaction. The commitments made by Big Rivers in the letter to Ambac were consistent with its plans to seek a refunding of the 2001A Bonds, in any event.

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<sup>4</sup> Ambac Assurance Corporation (“Ambac”), bond insurer for the 2001A Bonds.

<sup>5</sup> The July 16, 2009 letter to Ambac was filed in Case No. 2007-00455, The Applications of Big Rivers Electric Corporation for: (1) Approval of Wholesale Tariff Additions for Big Rivers Electric Corporation, (2) Approval of Transactions, (3) Approval to Issue Evidences of Indebtedness, and (4) Approval of Amendments to Contracts; and of E.ON U.S., LLC, Western Kentucky Energy Corp., and LG&E Energy Marketing, Inc. for Approval of Transactions (Ky. PSC Sept. 1, 2009).

Big Rivers seeks to refund the 2001A Bonds in order to reduce the risks and potential excess costs associated with a financing arrangement such as auction rate securities. The 2008 turmoil in the financial markets caused most investors to shy away from auction rate securities, which adversely affected the rates on the 2001A Bonds. As bond insurers began to be downgraded, the market for auction rate securities experienced difficulties, eventually failing on a regular basis. As a result, auction rate securities, including the 2001A Bonds, were sometimes forced to bear interest at their maximum rates. Big Rivers paid interest on the 2001A Bonds at average rates of 8.95 percent in 2008 and 11.74 percent in 2009 (through October), with rates at or near the maximum rate of 18 percent for much of 2009.

Because the 2001A Bonds are exposed to the market every 28 days, any adverse credit event affecting Big Rivers can be reflected almost immediately in the interest rates on the 2001A Bonds. According to Big Rivers, Ambac's credit support no longer has value,<sup>6</sup> and it will not mitigate any adverse credit event. While it is currently rated investment grade by three ratings agencies, Big Rivers' ratings can be negatively affected by a number of factors beyond its control such as environmental legislation, load reduction or notice of closure by one of the aluminum smelters on the Big Rivers system, or by the continuing depressed state of the wholesale power market, on which it relies for most of its margins.

Big Rivers states that each one-percent increase in the interest rate on the 2001A Bonds costs it \$833,000 annually. With projected margins of \$6.20 million for

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<sup>6</sup> Ambac has been downgraded a number of times since mid-2008. On June 19, 2009, Moody's Investor's Services ("Moody's") downgraded Ambac to "Aa3." On July 29, 2009, Moody's downgraded Ambac to "Caa2."



2010, and \$4.79 million for 2011, Big Rivers states that it cannot prudently risk a fluctuation in interest rates that would damage or eliminate its thin margins and its ability to meet the margins for interest ratio requirement in the Indenture.<sup>7</sup>

Big Rivers also points to a timing advantage with the proposed financing. The maturity date of the 2010A Bonds can be as late as August 31, 2031, compared to the 2001A Bonds' October 1, 2022 maturity date. This allows Big Rivers to avoid having to refinance the 2001A Bonds in late 2022, roughly one year before the December 31, 2023 due date of the Rural Utilities Service 2009 Promissory Note Series B in the amount of approximately \$243 million.

The closing date for sale of the 2010A Bonds will be determined after Big Rivers receives Commission approval to issue the proposed evidences of indebtedness. To advance the review process and to assure that the necessary approvals would be obtained in time for the Commission's Order to become final and non-appealable before the 2010A Bonds are sold, Big Rivers presented the documents for which it seeks approval in substantially complete form, still subject to comment by the parties to the documents. Once final comments are received from all creditors, Big Rivers stated that if a document changes, it will submit to the Commission a revision of the document showing those changes. Big Rivers indicated that it did not expect substantial changes in the forms of documents submitted.

#### FINDINGS AND ORDERS

The Commission, having considered the evidence of record and being otherwise sufficiently advised, finds that issuance of evidences of indebtedness requested by Big

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<sup>7</sup> Big Rivers' Indenture provides in Section 13.14 that it must maintain a margin for interest ratio of 1.10.

Rivers as set forth in its application will result in more stable and predictable interest costs, eliminate the interest rate risk associated with the auction rate provision of the existing 2001A Bonds, and provide for greater financial flexibility by extending the final maturity date of the debt evidenced by the 2001A Bonds. Consequently, the proposed evidences of indebtedness are for lawful purposes within Big Rivers' corporate purposes, are necessary for and consistent with the proper performance by Big Rivers of its service to the public, will not impair its ability to perform that service, and are reasonable, necessary, and appropriate for such purposes. Therefore, the issuance of the evidences of indebtedness as proposed by Big Rivers should be approved.

IT IS THEREFORE ORDERED that:

1. Big Rivers is authorized to enter into the 2010 Loan Agreement with Ohio County under which Ohio County will loan Big Rivers the entire amount of the 2010A Bonds in order to pay off the 2001A Bonds.
2. Big Rivers is authorized to issue its 2010A Note in the name of the trustee for the 2010A Bonds, U.S. Bank National Association, in an amount equal to the \$83.3 million aggregate principal amount of the 2010A Bonds.
3. Big Rivers is authorized to enter into the Supplemental Indenture with U.S. Bank National Association, under which the 2010A Note will be issued and secured.
4. Big Rivers is authorized to enter into the Guaranty provided by CFC, as set forth in its application, if the Guaranty will result in an economic benefit in the pricing and interest rate on the 2010A Bonds. In conjunction with the Guaranty, Big Rivers is authorized to: enter into the Reimbursement Agreement with CFC; purchase Equity

Certificates from CFC; enter into the CFC Loan Agreement; obtain the CFC Loan; and execute the CFC Note, all as set forth in its application.

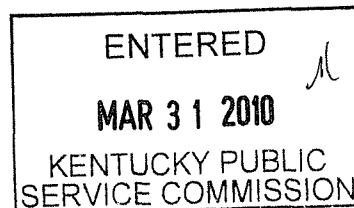
5. Big Rivers is authorized to execute, deliver, and perform its obligations under the agreements and documents as set out in its application and to perform the transactions contemplated by such agreements.

6. The proceeds from the transactions authorized herein shall be used only for the lawful purposes set out in Big Rivers' application.

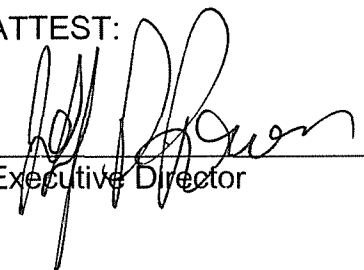
7. Big Rivers shall, within 30 days of the date of issuance, file with the Commission a statement setting forth the date or dates of issuance of the evidences of indebtedness authorized herein, the proceeds of such issuances, the interest rates, the maturity date(s), all fees and expenses involved in the issuance of these evidences of indebtedness, whether or not the Guaranty was entered into, and, if it was, the economic analysis showing the benefit of the Guaranty.

Nothing contained herein shall be deemed a warranty or finding of value of securities or financing authorized herein on the part of the Commonwealth of Kentucky or any agency thereof.

By the Commission



ATTEST:

  
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