COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENTUCKY POWER COMPANY FOR AUTHORITY PURSUANT TO KRS 278.300 TO ISSUE AND SELL PROMISSORY NOTES OF ONE OR MORE SERIES, TO ENTER INTO LOAN AGREEMENTS, AND FOR OTHER AUTHORIZATIONS IN CONNECTION WITH THE REFUNDING OF LIABILITIES ASSUMED BY THE COMPANY IN CONNECTION WITH THE MITCHELL TRANSFER	)	CASE NO. 2013-00410

ORDER

On November 18, 2013, Kentucky Power Company ("Kentucky Power") filed an application seeking Commission approval under KRS 278.300 authorizing it to issue notes and other evidences of indebtedness in the aggregate amount of $265 million. The financing application seeks approval for the issuance of up to $265 million in notes to refinance debt related to Kentucky Power's acquisition of an undivided 50 percent interest in the Mitchell Generating Station ("Mitchell Transfer") as approved in Case No. 2012-00578.[1] The Mitchell Transfer closed on December 31, 2013. The Attorney General of the Commonwealth of Kentucky, by and through his Office of Rate Intervention ("AG") and the Kentucky Industrial Utility Customers, Inc. ("KIUC")

[1] Case No. 2012-00578, Application of Kentucky Power Company for (1) A Certificate of Public Convenience and Necessity Authorizing the Transfer to the Company of an Undivided Fifty Percent Interest in the Mitchell Generation Station and Associated Assets; (2) Approval of the Assumption by Kentucky Power Company of Certain Liabilities in Connection with the Transfer of the Mitchell Generating Station; (3) Declaratory Rulings; (4) Deferral of Costs Incurred in Connection with the Company's Efforts to Meet Federal Clean Air Act and Related Requirements; And (5) All Other Required Approvals and Relief (Ky. PSC Nov. 15, 2013).

requested and were granted full intervention. On December 13, 2013, the Commission issued an order establishing a procedural schedule for processing this case. The procedural schedule provided for discovery, intervenor testimony, rebuttal testimony by Kentucky Power, and for requests for a formal evidentiary hearing or for waiver of hearing. On February 6, 2014, Kentucky Power filed a motion requesting that the Commission decide this matter based on the evidentiary record, given that no intervenor testimony or comments have been filed, and waiving the need for a formal hearing. Neither the AG nor KIUC have filed any objections to Kentucky Power's motion. The Commission finds that Kentucky Power has established good cause to have this matter be decided upon the evidentiary record and will grant Kentucky Power's motion to submit the proceeding for a decision on the record.

DISCUSSION

Issuance of up to $200 million of Unsecured Promissory Notes

Kentucky Power proposes to issue and sell up to $200 million aggregate principal amount of unsecured promissory notes in one or more new series in one or more transactions through December 31, 2015. However, in response to a Commission Staff request for information, Kentucky Power stated that it expects to refinance the $200 million within six months of the December 31, 2013 Mitchell Transfer pending market conditions. Kentucky Power states that the proposed notes will have maturities ranging from a minimum of nine months to a maximum of 60 years; will be sold by competitive bidding, by private offering through negotiation with underwriters or agents, or by direct placement with a commercial bank or institutional investor; and that the interest rates may be fixed or variable, depending on which is most advantageous at the time of the issuance and sale of the notes. In response to an AG data request, Kentucky Power stated that it is most likely to access the private placement market for its debt issuances, because it is not registered with the U.S. Securities Exchange Commission. According to Kentucky Power, any fixed-rate interest notes will have a yield to maturity not to exceed that of United States Treasury bonds of comparable maturity at the time of pricing plus 500 basis points, with initial fluctuating rate of interest not to exceed 8 percent per annum at the time of issuance. Kentucky Power states that it will agree to any specific redemption provisions, including redemption premiums, at the time of pricing, and that it may provide the notes with some form of credit enhancement if such is deemed advisable.

According to Kentucky Power's application, one more notes may be issued in connection with long-term borrowings by its parent company, American Electric Power Company, Inc. ("AEP"), or with any entity owning either directly or indirectly all of Kentucky Power's common stock. Any such borrowings will have interest rates and maturity dates that parallel AEP's cost of capital in order to comply with any applicable law or regulation.

Kentucky Power states that it may agree to restrictive covenants in connection with the sale of the notes. Such covenants may, among other things, prohibit it from creating or permitting liens on its property; creating indebtedness other than what is specified; failing to maintain a certain financial condition; entering into mergers, consolidations, and dispositions of assets; and permitting the occurrence of certain events in connection with pension plans.

According to Kentucky Power, present market conditions make it difficult to determine whether it will be more advantageous to sell the proposed notes with a 60-year maturity or with some shorter period. It further states that, in order to obtain the best possible price, interest rate, and terms, it is in the public interest to afford it the flexibility to adjust its financing program as developments in the medium- and long-term debt markets occur. Kentucky Power therefore requests that it be permitted to determine at a subsequent date whether there will be more than one series and the associated maturity of each series.

Kentucky Power contends that any notes will likely be issued under a new indenture or under the September 1, 1997 indenture with Deutsche Bank Trust Company Americas, Trustee, or with any eligible and qualified successor. Kentucky Power states that the total issuance costs for the notes will be approximately $1.092 million.[2]

Kentucky Power proposes to use the proceeds from the $200 million in unsecured promissory notes to refund an intercompany note used to finance the assets it acquired in the Mitchell Transfer, as explained in footnote 7 on page 6 of its application, and as contemplated in the application in Case No. 2012-00578.[3]

Issuance of $65 Million in West Virginia Economic Development Authority ("WVEDA") Solid Waste Disposal Facilities Revenue Bonds

As explained in Kentucky Power's application, the existing $65 million WVEDA bonds were issued by WVEDA on behalf of Kentucky Power's affiliate, Ohio Power

[2] Kentucky Power Responses to Commission Staff's First Request for Information, Item 5, Attachment 1.

[3] Case No. 2012-00578, Application (filed Dec. 19, 2012), page 17, paragraph 43.

Company ("Ohio Power") and are held in trust by Ohio Power. The WVEDA bonds cannot be transferred directly to Kentucky Power from Ohio Power, but the economic obligations represented by the bonds were transferred to Kentucky Power as part of the process of completing the Mitchell Transfer. The $65 million of existing WVEDA bonds will be redeemed and retired by the proceeds from WVEDA's issuance, on behalf of Kentucky Power, of a new series of Solid Waste Disposal Facilities Revenue Bonds. Kentucky Power states that it anticipates refunding the existing WVEDA bonds within six months following the asset transfer, but no later than December 31, 2015, and will receive the proceeds of the new bonds. According to Kentucky Power, the new WVEDA bonds will give it the flexibility to issue tax-exempt debt and is expected to reduce the embedded cost of its long-term debt.

Kentucky Power states that each series of new WVEDA bonds will be sold in one or more underwritten public offerings, direct bank loans, credit agreements or facilities, negotiated sales, or private placement transactions. Although Kentucky Power states that it will not be a party to the underwriting, placement or other arrangements for the new WVEDA bonds, the applicable Loan Agreement, as described more fully below, will provide that the series of new bonds will have such terms as shall be specified by Kentucky Power. Each series of new bonds, according to the application, would be issued pursuant to one or more indentures (each an "Indenture") between the WVEDA and a trustee. In no event will the amount of new bonds issued exceed a total of $65 million. The price, maturity date, interest rate, redemption provisions, and other terms and provisions of each series of new bonds will be determined on the basis of negotiations between Kentucky Power, the WVEDA, and the purchasers of such bonds.

Kentucky Power requests the Commission's authority to enter into one or more guaranty agreements, bond insurance agreements and other similar undertakings guaranteeing repayment of any part of the obligations under one or more series of new bonds for the benefit of the bond holders.

Because the new bonds will be issued by WVEDA and not Kentucky Power, Kentucky Power will assume financial responsibility for payments on and in connection with the new bonds through a Loan Agreement, which is described in the application as follows (with some stylistic changes incorporated):[4]

- In consideration of the payment of the proceeds of the new bonds to the WVEDA Bond Trustee to redeem and retire the currently outstanding $65 million principal amount of the WVEDA Bonds, the economic rights and liabilities of which will be held by Kentucky Power, and the consequent extinguishment of the note used to accomplish the Mitchell Transfer from Ohio Power to Kentucky Power as described in the instant application, Kentucky Power proposes to execute one or more loan or installment payment agreements with WVEDA which collectively will constitute the Loan Agreement. The payments to be made by Kentucky Power under the Loan Agreement for one or more series of new WVEDA bonds, together with other funds available for that purpose, are to be sufficient to pay the principal, purchase price or premium, if any, and interest on such new bonds. The Loan Agreement and the payments to be made by Kentucky Power applicable to each series of new WVEDA bonds will be assigned to the applicable trustee to secure the payment of the principal and interest on the related new bonds.

[4] Application, pages 14 and 15.

- The Loan Agreement for each WVEDA bond series will provide that each loan payment (or installment of the purchase price for the applicable project) payable by Kentucky Power will be in such an amount (together with other moneys held by the Trustee under the Indenture for that purpose) as will enable the WVEDA to pay, when due, the interest on all new bonds and any additional bonds and refunding bonds issued under the Indenture for that series; the stated maturities of the principal of all new WVEDA bonds and any additional bonds and refunding bonds issued under the indenture for that series; and amounts, including any accrued interest, payable in connection with any redemption of the new bonds and any additional bonds or refunding bonds issued under the Indenture for that series.

- The Loan Agreement also will obligate Kentucky Power to pay the fees and charges of the Trustee, as well as certain administrative expenses of the WVEDA. Kentucky Power will not agree, without further Order of this Commission, to the issuance of any series of new bonds whose stated maturity shall be more than 40 years; whose fixed rate of interest shall exceed 8 percent or, with respect to variable rate bonds, whose initial rate of interest shall exceed 8 percent; whose discount from the initial public offering price shall exceed 5 percent of the principal amount; or whose initial public offering price shall be less than 95 percent of the principal amount.

Kentucky Power estimates in its application that other issuance costs, excluding underwriting fees, for the new WVEDA bonds will total approximately $300,000 based on its experience with similar financings. In response to a Commission Staff Request for Information, Kentucky Power provided more detailed information showing total issuance cost of approximately $566,000.[5] Kentucky Power was also asked to provide an estimate of the benefit to Kentucky Power in assuming the $65 million of WVEDA bonds as opposed to refinancing the $65 million through a long-term debt issuance. Kentucky Power stated that it could be possible to achieve a 410 to 440 basis-point savings by issuing tax-exempt securities as opposed to a private placement bond.[6]

With respect to both the refunding of the debt related to the Mitchell Transfer and the WVEDA bonds, Kentucky Power states that it may purchase outstanding securities through tender offer, negotiated or open-market purchase or any other form of purchase if such refunding can be accomplished at a lower effective cost than by redemption. Kentucky Power will determine that any premium paid with respect to a tender offer is prudent compared to savings in interest expense associated with early redemption of any series, and proposes to treat any premium paid as an expense to be amortized over the life of the new bonds or notes. Kentucky Power maintains that it intends to use deferred tax accounting for the premium expense to properly match amortization of the expense with the related tax effect.

Kentucky Power states that the actual cost associated with the promissory notes and the new WVEDA bonds will be determined at the time of sale. Kentucky Power points out that the net effect of the debt issuances will be reflected in the determination of revenue requirements in future rate proceedings in which all factors affecting rates will be taken into account according to law.

---

[5] Kentucky Power Responses to Commission Staff's First Request for Information, Item 5, Attachment 1.

[6] Kentucky Power Responses to Commission Staff's First Request for Information, Item 3.b.

Kentucky Power maintains that it will, within 30 days after the issuance of each series of the promissory notes and new WVEDA bonds, file a verified statement with the Commission disclosing the date or dates of issuance, the price paid, the interest rate, the purchasers, and an estimate of all fees and expenses including underwriting discounts or commissions or other compensation paid by Kentucky Power in connection with the issuance and distribution of the indebtedness.

Use of Treasury Hedge and Interest Rate Management Agreements

Kentucky Power requests authorization to enter into one or more interest rate hedging agreements from time to time through December 31, 2015, in connection with the issuance of both the promissory notes and the new WVEDA bonds. The proposed interest rate hedging arrangements could include, but are not limited to, treasury lock agreements; forward-starting interest rate swaps; and treasury put options or interest rate collar agreements ("Treasury Hedge Agreement") to protect against future interest rate movements in connection with the issuance of the proposed notes and new WVEDA bonds. Each Treasury Hedge Agreement will correspond to one or more issuances of indebtedness proposed in its Application; the aggregate corresponding principal amounts of all Treasury Hedge Agreements will therefore not exceed, on the date or dates of entering such agreements, $265 million.

Kentucky Power proposes to utilize interest rate management techniques and enter into Interest Rate Management Agreements through December 31, 2015, to allow it sufficient alternatives and flexibility to reduce its effective interest cost and manage interest cost on financings. The proposed Interest Rate Management Agreements will consist of "interest rate swaps," "caps," "collars," "floors," "options," or hedging products such as "forwards" or "futures", or similar products, the purpose of which is to manage and minimize interest costs. Kentucky Power states that it expects to enter into these agreements with counterparties that are highly rated financial institutions. The transactions will be for a fixed period and a stated principal amount, and shall be for underlying fixed or variable obligations of Kentucky Power. It will not agree to any covenant more restrictive than those contained in the underlying obligation unless such Interest Rate Management Agreement either expires by its terms or is unwindable on or prior to the end of the authorization period.[7]

Because market opportunities for these interest rate management alternatives are transitory, Kentucky Power states that it must be able to execute interest rate management transactions when the opportunity arises to obtain the most competitive pricing. Kentucky Power seeks approval to enter into any or all of the described transactions within the parameters discussed above prior to the time it reaches agreement with respect to the terms of such transactions.

The use of Interest Rate Management Agreements could cause Kentucky Power's annual long-term interest charges to change. Kentucky Power acknowledges that the Commission's authorization of the use of Interest Rate Management Agreements as described in the application does not relieve it of its responsibility to obtain the best terms available for the product selected. It contends, therefore, that it is appropriate and reasonable for the Commission to authorize Kentucky Power to agree to such terms and prices consistent with the stated parameters.

Kentucky Power states that the loan proceeds from the promissory notes will provide long-term financing for the debt assumed in conjunction with the Mitchell

---

[7] Application, page 17.

Transfer. Kentucky Power points out that the Commission approved the Mitchell Transfer and associated debt in Case No. 2012-00578, and that therefore the promissory notes are for a lawful object within the corporation purposes of Kentucky Power, are necessary and appropriate for, and consistent with the proper performance of its service to the public, and will not impair its ability to provide that service.

Kentucky Power further states that the Loan Agreement will permit it to take advantage of low-cost financing through refunding the WVEDA bonds, which it will hold in trust following the Mitchell Transfer. These funds may be used for general corporate purposes and to refinance a portion of the debt related to the Mitchell Transfer at lower rates than could be obtained through issuance of the notes. Therefore, according to Kentucky Power, the Loan Agreement is for a lawful object within the corporate purposes of Kentucky Power, is necessary and appropriate for, and consistent with the proper performance of its service to the public, and will not impair its ability to provide that service.

Kentucky Power also states that the guaranty agreements, bond insurance agreements, and similar undertakings in connection with the issuance of the new WVEDA bonds will facilitate the issuance of the bonds, as well as Kentucky Power's ability to take advantage of the low-cost financing available through refunding the WVEDA bonds. Kentucky Power states that, as a result, these agreements are for a lawful object within the corporate purposes of Kentucky Power, are necessary and appropriate for, and consistent with the proper performance of its service to the public, and will not impair its ability to provide that service.

The Commission, having considered the evidence of record and being otherwise sufficiently advised, finds that (1) the proposal to issue and sell, in one or more transactions through December 31, 2015, up to $200 million aggregate principal amount of unsecured promissory notes in one or more new series; (2) the refunding of the existing $65 million in WVEDA bonds and the subsequent reissuance of new WVEDA bonds through the Loan Agreement as described in the application; (3) the guaranty agreements, bond insurance agreements, and other undertakings which will facilitate Kentucky Power's ability to take advantage of low-cost financing available through refunding the WVEDA bonds as described in the application; and (4) the use of interest rate management agreements as described in the application are for lawful objects within the corporate purposes of Kentucky Power's utility operations, are 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, are reasonably necessary and appropriate for such purposes, and should therefore be approved. Kentucky Power should further be authorized to execute, deliver and perform its obligations under all agreements and documents as set out in its application, and to perform the transactions contemplated by such agreements. The Commission further finds that, when Kentucky Power files its statement setting out the details of each debt issuance as required in ordering paragraph 7 below, it should include an explanation of the chosen terms of the indebtedness, including the use of fixed or variable interest rates, and why the terms were considered most advantageous in both the short- and long-term at the time of the issuance of the indebtedness.

IT IS THEREFORE ORDERED that:

1. Kentucky Power's proposal to issue and sell, in one or more transactions through December 31, 2015, up to $200 million aggregate principal amount of unsecured promissory notes in one or more new series is approved.

2. Kentucky Power's proposal to refund the existing $65 million in WVEDA bonds and subsequently assume financial responsibility for the new $65 million issuance of WVEDA bonds through the Loan Agreement as described in the application is approved.

3. Kentucky Power's proposed use of guaranty agreements, bond insurance agreements, and other undertakings which will facilitate Kentucky Power's ability to take advantage of low-cost financing available through refunding the WVEDA bonds as described in the application is approved.

4. Kentucky Power's proposed use of interest rate management agreements as described in the application is approved.

5. The proceeds from the proposed financing shall be used only for the lawful purposes set out in Kentucky Power's application.

6. The Notes authorized herein shall not be issued to an affiliate unless the interest rate is no more than the cost of capital of AEP and the interest rate is equal to or lower than the interest rate on debt available to Kentucky Power from a non-affiliate at the time of issuance.

7. Kentucky Power shall, within 30 days of the issuance, file with the Commission a statement setting forth the date or dates of issuance of the evidences of indebtedness or use of Treasury Hedge or Interest Rate Management Agreements

authorized herein, the proceeds of such issuances, the interest rate(s), the maturity date(s), all fees and expenses involved in the issuances of these evidences of indebtedness or use of such agreements.

8. Any document filed pursuant to ordering paragraph 7 of this Order shall reference the number of this case and shall be retained in the utility's general correspondence file.

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

ENTERED
MAR 25 2014
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

Executive Director

Kenneth J Gish, Jr.
Stites & Harbison
250 West Main Street, Suite 2300
Lexington, KENTUCKY 40507

Jennifer B Hans
Assistant Attorney General's Office
1024 Capital Center Drive, Ste 200
Frankfort, KENTUCKY 40601-8204

Honorable Michael L Kurtz
Attorney at Law
Boehm, Kurtz & Lowry
36 East Seventh Street
Suite 1510
Cincinnati, OHIO 45202

Honorable Mark R Overstreet
Attorney at Law
Stites & Harbison
421 West Main Street
P. O. Box 634
Frankfort, KENTUCKY 40602-0634

Ranie Wohnhas
Managing Director
Kentucky Power Company
101 A Enterprise Drive
P. O. Box 5190
Frankfort, KY 40602