STITES & HARBISON PLLC

ATTORNEYS

421 West Main Street
Post Office Box 634
Frankfort, KY 40602-0634
[502] 223-3477
[502] 223-4124 Fax
www.stites.com

February 20, 2006

Mark R. Overstreet
(502) 209-1219
(502) 223-4387 FAX
moverstreet@stites.com

HAND DELIVERED

Ms. Beth O'Donnell
Executive Director
Public Service Commission of Kentucky
211 Sower Boulevard
P.O. Box 615
Frankfort, Kentucky 40602-0615

RECEIVED

FEB 20 2006

PUBLIC SERVICE COMMISSION

RE: P.S.C. Case No. 2006-00034

Dear Ms. O'Donnell:

Enclosed please find and accept for filing the original and ten copies of Kentucky Power Company's Response to the Staff's First Data Request. Please call if you have any questions.

Sincerely yours,

STITES & HARBISON, PLLC

Mark R. Overstreet

KE057:KE183:13684:1:FRANKFORT

BEFORE THE

KENTUCKY PUBLIC SERVICE COMMISSION

RECEIVED

FEB 2 0 2006

PUBLIC SERVICE COMMISSION

In the Matter of:	)	
	)	
The Application Of	)	
Kentucky Power Company,	)	Case No. 2006-00034
For Authorization to Issue and Sell	)	
Secured or Unsecured Promissory Notes	)	
of One or More New Series	)	

KENTUCKY POWER COMPANY

RESPONSES TO STAFF'S FIRST DATA REQUEST

Dated February 10, 2006

KENTUCKY POWER COMPANY

REQUEST:

Refer to the application, page 5, last paragraph. Explain in detail the debt instruments described as "Trust Preferred Securities" and "tax advantaged preferred securities." Your explanation should include the reasons why these types of securities might be issued rather than the notes described in the application, as well as any advantages or disadvantages of such securities.

RESPONSE:

A trust preferred security is a type of security that possesses characteristics of both equity and debt. Trust preferred securities issued by a trust are analogous to preferred stock issued by a corporation — holders of each generally have the right to pre-defined cash distributions at regular intervals, subject to the issuer's right to defer distributions. Just as a corporation needs a source of cash to pay distributions on its preferred stock, a trust needs a source of cash to pay distributions on its preferred securities held by investors. The trust obtains this cash flow from interest payments on a loan that it made to the company that formed and owns it: (1) a company creates a trust and retains the right to manage it, (2) the trust sells preferred securities to the public, (3) the trust loans the proceeds to the its parent, the company that formed and manages it, (4) the company pays interest on the loan to the trust, (5) the trust distributes the interest to the public purchasers of its preferred securities. The trust acts as a pass-through for interest payments on the loan from the company, which it passes through to the public purchasers of its preferred securities. When the loan is due, the company pays the trust back and the trust redeems its preferred securities. The loan permits the company to defer the payment of interest for certain intervals, and the trust is likewise permitted to defer distributions on its preferred securities. The company guarantees the payment of the trust preferred securities. For accounting purposes, the inter-company loan from the trust to the company is eliminated through consolidation and the company is deemed the obligor on the preferred securities.

Recently introduced variations include tax advantaged preferred securities. Specifically, these securities are taxed like debt obligations by the IRS, while retaining some equity characteristics for the rating agencies. They are recorded as debt in a company's accounting statements as according to GAAP procedures.

In 2005, Moody's Investors Service (Moody's) and Standard & Poor's (S&P) changed their credit policies to allow for partial equity credit for certain preferred and trust preferred securities. The rating agencies' interpretation of equity content is dependent on the legal form and nomenclature of the security.

Equity content is the percent of the notional amount of an issued security that is included in the equity component of the capitalization ratio as calculated by a rating agency. Moody's classifies equity content according to a basket system, where the security is assigned a basket from A (most debt-like) to E (most equity-like). S&P classifies an issuance as high, intermediate, or minimal equity categories. The rating agencies rate the security one or two notches below the issuing company's senior unsecured credit rating. Accordingly, the security would be issued at a higher spread than that of the company's senior unsecured notes. Also, S&P released guidelines that the aggregate issuance amount should be limited to approximately 15% of a company's book capitalization.

The Applicant continues to evaluate these securities as an alternative to debt and equity funding choices. Trust Preferred securities currently would be approximately 1% more expensive than debt. Applicant would consider using Trust Preferred Securities in instances where the ratings of such securities would be higher than the ratings on securities which are pure debt or pure equity. Applicant desires the flexibility to issue Trust Preferred Securities when it is advantageous to Kentucky Power to do so.

WITNESS: Errol K. Wagner