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PUBLIC SERVICE COMMISSION

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Ms. Stephanie L. Stumbo
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
P.O. Box 615
Frankfort, Kentucky 40602-0615

August 28, 2008

Re: The Application of Kentucky Utilities Company for an Order Authorizing the Issuance of Securities and the Assumption of Obligations – *Case No. 2008-00309*

Dear Ms. Stumbo:

Please find enclosed for filing the original and four copies of Kentucky Utilities Company's Response to the Commision Staff's First Data Request dated August 19, 2008, in the aforementioned proceeding.

Should you have any questions concerning the enclosed, please do not hesitate to contact me.

Sincerely,

Rick E. Lovekamp

Rick E. Lovekamp

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 SECURITIES AND THE ASSUMPTION OF OBLIGATIONS	)))))	CASE NO. 2008-00309

RESPONSE OF
KENTUCKY UTILITIES COMPANY
TO
FIRST DATA REQUEST OF COMMISSION STAFF
DATED AUGUST 19, 2008

FILED: August 29, 2008

VERIFICATION

STATE OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

The undersigned, **Daniel K. Arbough**, being duly sworn, deposes and says that he is Treasurer, for E.ON U.S. Services Inc., that he has personal knowledge of the matters set forth in the responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

Daniel K. Arbough

DANIEL K. ARBOUGH

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 28th day of August, 2008.

Rhonda P. Andrews (SEAL)
Notary Public

My Commission Expires:
August 31, 2011

KENTUCKY UTILITIES COMPANY

Response to First Data Request of Commission Staff
Dated August 19, 2008

Case No. 2008-00309

Question No. 1

Witness: Daniel K. Arbough

Q-1. Refer to page 2 of the application.

a. KU states that the Kentucky Private Activity Bond Allocation Committee awarded it $ 18,026,265 of the state cap for private activity bonds. Provide a brief description of the Kentucky Private Activity Bond Allocation Committee ("Committee"), private activity bonds, and the reason why KU can receive an allocation from the Committee.

b. Explain why this type of financing results in tax-exempt financing.

A-1. a. The Committee is established by KRS 103.210, with membership comprised of the Secretary of the Finance and Administration Cabinet (Chair), Secretary of the Cabinet for Economic Development, State Budget Director, State Controller, and Secretary of the Governor's Executive Cabinet, or their designees. The purpose of the Committee is to ensure that "private activity bonds" issued by the Commonwealth, its political subdivisions, and other authorized issuers within the Commonwealth, comply with the state ceiling (allocated to each state based on population) imposed by the Tax Reform Act of 1986, 26 U.S.C. Section 146.

"Private Activity Bonds" are defined in 26 U.S.C. Section 141. In brief, Private Activity Bonds are bonds issued by a governmental issuer, but proceeds from which are used for a "qualified private business" use, which is beneficial to the public, such as airports, water facilities, solid waste disposal facilities, etc. In the present case, the bonds would be issued by Carroll County, and the proceeds then loaned to KU in connection with financing portions of KU's solid waste disposal project.

Under 26 U.S.C. Section 142, (and subject to various limitations) these bonds qualify as "Exempt Facility Bonds," which may be issued as tax-exempt debt, if used to finance, among other things, solid waste disposal facilities. The proceeds from the Bonds to be issued by Carroll County, which are the subject of this Application, will be used to provide permanent financing for portions of KU's pollution control project which qualify as solid waste disposal facilities. Carroll County's actions are authorized by KRS 103.210 which provides for issuance of such bonds for various purposes, including defraying the costs of pollution control. KU's financing of its pollution control project qualifies as a private business use under 26 U.S.C. Section 141, and because the proceeds will be used to finance Exempt Facilities, KU was entitled to apply for and receive an allocation from the Committee.

b. This Application involves Private Activity Bonds allocated by the Committee in compliance with the state ceiling imposed by the Tax Reform Act of 1986 and issued to finance Exempt Facilities as defined in 26 U.S.C. Section 142 and which are therefore recognized under 26 U.S.C. Sections 141-146 as tax-exempt.

KENTUCKY UTILITIES COMPANY

Response to First Data Request of Commission Staff
Dated August 19, 2008

Case No. 2008-00309

Question No. 2

Witness: Daniel K. Arbough

Q-2. Refer to page 3 of the application. KU requests authority to assume certain obligations under agreements it will enter into in connection with the issuance of one or more series of Carroll County Environmental Facilities Revenue Bonds ("Pollution Control Bonds").

a. Does the allocation of $18,026,265 from the Committee determine the amount of Pollution Control Bonds that Carroll County will issue on behalf of KU?

b. Provide the dollar amount of the Initial Facility that KU may use to replace bond insurance for the pollution control bond issuance.

A-2. a. Yes. As stated in response to Q-1, the total amount of Private Activity Bond authority allocated for projects within the state is limited. $18,026,265 was the maximum amount that could be allocated to any single project at the meeting of the Committee on July 23, 2008 and is the maximum amount of bonds which may be issued under this allocation of a portion of the State Ceiling for such bonds.

b. Any Initial Facility would be intended to assure the financial markets that KU will have sufficient funds available for purchase of any variable rate bonds that were tendered for purchase but were not remarketed. Thus, the maximum amount of any Initial Facility could correspond to the total amount of outstanding Pollution Control Bonds that were issued at a variable interest rate. The Initial Facility could be used to fund the purchase of variable rate Pollution Control Bonds that were not remarketed, and thus as debt was drawn on the Initial Facility, corresponding Pollution Control Bonds would be repurchased by KU pending future remarketing, at which time the obligation under the Initial Facility would be cancelled.

KENTUCKY UTILITIES COMPANY

Response to First Data Request of Commission Staff
Dated August 19, 2008

Case No. 2008-00309

Question No. 3

Witness: Daniel K. Arbough

Q-3. Refer to page 8 of the application.

a. Explain how entering into hedging agreements will limit KU's exposure to variable interest rates or lower the overall borrowing costs on fixed rate Pollution Control Bonds.

b. KU states that the estimated cost of financing does not include the costs of any hedging facility, although currently there is no cost for a 3-year hedge. Will KU use only 3-year hedges?

c. If the answer to 3(b) is no, explain why the cost for a 3-year hedge is relevant.

A-3. a. A Hedging Facility can accomplish the objective of either limiting exposure to variable interest rates if the underlying bond is in a variable rate mode or lowering the overall borrowing costs on fixed rate bonds.

To limit exposure to variable rates, a Hedging Facility could be entered into wherein the Company pays a fixed rate and receives a variable rate. The variable rate received under the Hedging Facility is designed to offset the variable rate paid under the bond. Thus, the Hedging Facility converts the variable rate bond to a fixed obligation for the term of the Hedging Facility.

To lower the overall costs of a fixed rate bond, a Hedging Facility could be completed wherein the company pays a variable rate and receives a fixed rate. The fixed rate received in the Hedging Facility is designed to offset the fixed rate paid under the bond. Thus, the Hedging Facility converts the fixed rate bond to a variable rate obligation. Historically, the variable rates in the tax-exempt market have been lower than the fixed rates. Therefore, a Hedging Facility could allow the Company to lower the borrowing costs.

b. No decision has been made as to whether or not a Hedging Facility will be used. There is no intention of using only 3 year hedges.

c. A 3-year Hedging Facility was included for illustrative purposes only.

KENTUCKY UTILITIES COMPANY

Response to First Data Request of Commission Staff
Dated August 19, 2008

Case No. 2008-00309

Question No. 4

Witness: Daniel K. Arbough

Q-4. Refer to the second and fourth pages of Tab 2. Explain the basis for the discount rates.

A-4. The discount rates used in the Present Value Analysis are the after-tax cost of a taxable loan. Provided below is the detail explaining the calculation:

Discount Rate = Taxable Loan Rate* x (1 – Tax Rate)

Fixed Rate Calculation
Discount Rate = 6.490% x (1 – 40.363%) = 3.87%

Variable Rate Calculation
Discount Rate = 3.990% x (1- 40.363%) = 2.38%

The 3.87% discount rate was used in comparing a tax-exempt fixed rate loan to a taxable fixed rate loan. The 2.38% discount rate was used in comparing a tax-exempt variable rate loan to a taxable variable rate loan.

* Taxable Loan Rate was determined as follows:

Fixed Taxable Loan Rate
30-Year Treasury (4.61%) + Spread for Similar Rated Issue (1.88%) = Fixed Taxable Loan Rate (6.49%)

Variable Taxable Loan Rate
10-Year Avg. CP (3.74%) + Remarketing Fee (0.25%) = Variable Taxable Loan Rate (3.99%)