

a PPL company

Jeff DeRouen, Executive Director  
Public Service Commission of Kentucky  
211 Sower Boulevard  
P. O. Box 615  
Frankfort, Kentucky 40602

RECEIVED

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PUBLIC SERVICE  
COMMISSION

October 4, 2011

**Kentucky Utilities Company**  
State Regulation and Rates  
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PO Box 32010  
Louisville, Kentucky 40232  
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**RE: *The Application of Kentucky Utilities Company for Certificates of Public Convenience and Necessity and Approval of Its 2011 Compliance Plan for Recovery by Environmental Surcharge***  
**Case No. 2011-00161**

Dear Mr. DeRouen:

Enclosed please find an original and fifteen (15) copies of Kentucky Utilities Company's (KU) supplemental response to Question No. 16 of the Commission Staff's First Information Request dated July 12, 2011, in the above-referenced matter.

Should you have any questions regarding the enclosed, please contact me at your convenience.

Sincerely,

A handwritten signature in black ink, appearing to read 'R. M. Conroy', followed by a large, stylized flourish or scribble.

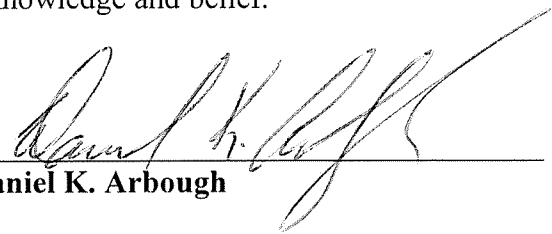
Robert M. Conroy

cc: Parties of Record

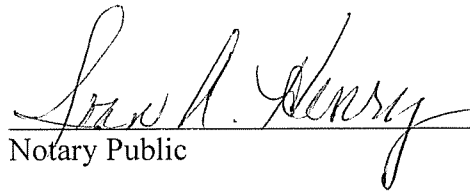
VERIFICATION

COMMONWEALTH OF KENTUCKY )  
 ) SS:  
COUNTY OF JEFFERSON )

The undersigned, **Daniel K. Arbough**, being duly sworn, deposes and says that he is Treasurer for Kentucky Utilities Company and an employee of LG&E and KU Services Company, and 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

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 4<sup>th</sup> day of October 2011.

 (SEAL)  
Notary Public

My Commission Expires:  
July 21, 2015

**KENTUCKY UTILITIES COMPANY**

**Response to the Commission Staff's First Information Request Dated July 12, 2011**

**Supplemental Response filed October 4, 2011**

**Case No. 2011-00161**

**Question No. 16**

**Witness: Daniel K. Arbough**

Q-16. Provide a copy of KU's latest reports from its bond rating agencies and any other reports from rating agencies and or banks which discuss any risks facing the company which will affect its ability to borrow the necessary project funds.

A-16. **Original Response:**

The most recent bond rating agency reports for the Company are attached. The Company is not aware of reports issued by banks which discuss risks facing the Company in borrowing the necessary funds to construct the proposed projects.

**Supplemental Response:**

Please see the attached bond rate agency reports for the Company issued recently.

**Attachment to KPSC Question No. 16 – Standard & Poors, *Global Credit Portal* (KU)  
dated September 23, 2011  
Witness: Arbough**

**Summary:**  
**Kentucky Utilities Co.**

**Primary Credit Analyst:**

Gerrit Jepsen, CFA, New York (1) 212-438-2529; gerrit\_jepsen@standardandpoors.com

**Secondary Credit Analyst:**

Barbara A Eiseman, New York (1) 212-438-7666; barbara\_eiseman@standardandpoors.com

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Rationale

Outlook

Related Criteria And Research

## Summary:

# Kentucky Utilities Co.

**Credit Rating:** BBB/Stable/A-2

## Rationale

Standard & Poor's Ratings Services bases its rating on vertically integrated electric utility Kentucky Utilities Co. (KU) on the consolidated credit profile of ultimate parent PPL Corp., which includes what we consider to be an excellent business risk profile and aggressive financial risk profile. (For more on business risk and financial risk, see "Business Risk/Financial Risk Matrix Expanded," published May 27, 2009, on RatingsDirect on the Global Credit Portal.) In the U.S., holding company PPL Corp. consists of KU and other vertically integrated utility subsidiary Louisville Gas & Electric Co. (LG&E). In addition, PPL Corp. owns transmission and distribution electric utility PPL Electric Utilities Corp. (PPELU) and PPL Energy Supply LLC, an unregulated generation subsidiary that has 10,760 megawatts of unregulated generation capacity that consists of well-located, low-cost nuclear and coal plants that are well hedged through 2012. In the U.K., PPL Corp. owns electric distribution networks Western Power Distribution (South West) PLC, Western Power Distribution (South Wales) PLC, Western Power Distribution (West Midlands) PLC, and Western Power Distribution (East Midlands) PLC. PPL Corp.'s rating reflects a mostly regulated utility strategy that will include continuous capital spending and timely cost recovery through various regulatory mechanisms.

The excellent business risk profile incorporates PPL Corp.'s strategy as a mostly regulated public utility holding company. PPL Corp.'s numerous utilities serve 10 million electric customers in the U.K., Pennsylvania, and Kentucky, and 320,000 natural gas distribution customers in Kentucky. The U.K. wires-only distribution utilities have credit-supportive U.K. regulation and no commodity risk because nonaffiliated retail suppliers procure the electricity for retail customers. We expect these U.K. operations to contribute about 30% of PPL Corp.'s consolidated cash flow. The stability of the U.K. cash flows, along with existing utility assets in Kentucky and Pennsylvania, all of which we assess as excellent, will more than offset the business risk profile of PPL Energy's merchant generation, which we assess as satisfactory, resulting in the excellent business profile overall. We expect the merchant generation business to comprise less than 25% of pro forma consolidated cash flows.

KU's consolidated business risk profile, which we consider excellent, reflects the strengths of serving electric customers scattered throughout Kentucky, including those in Lexington. The utility's strengths include relatively predictable utility operations with steady cash flows, constructive cost recovery, and relatively low rates stemming from low-cost coal-fired generation. Although most of its plants burn coal, they meet current environmental requirements, and the significant amount of capital spending needed for environmental compliance through 2015 should be recoverable through rates.

The financial risk profile for KU reflects that of PPL Corp. The consolidated financial profile, which we consider aggressive, reflects adjusted financial measures that are in line with the rating. We expect that financial measures will continue at current levels as the company incorporates full cost recovery of capital spending in operating cash flow. We expect consolidated financial measures, including ratios of debt to EBITDA, funds from operations (FFO) to total debt, and debt to capital, to remain in line with the rating. For the 12 months ended June 30, 2011, FFO to

total debt was 16.5%, total debt to total capital was about 58%, and debt to EBITDA was 4.8x. After reducing cash flow from operations by capital spending and dividends, discretionary cash flow was negative \$275 million, indicating a need for external funding. In addition, net cash flow (FFO after dividends) to capital spending was 101%. FFO interest coverage was 4.1x, and the company's dividend payout ratio was 50%. The consolidated adjustments for PPL Corp. include pension-related items, intermediate equity treatment of the junior subordinated notes, and high equity treatment of mandatory convertible securities.

### Liquidity

The short-term rating on KU is 'A-2'. The utility's liquidity position reflects that of parent PPL Corp., which we consider adequate under Standard & Poor's liquidity methodology. (We categorize liquidity in five standard descriptors. See "Standard & Poor's Standardizes Liquidity Descriptors for Global Corporate Issuers," published July 2, 2010.)

We base our liquidity assessment on the following factors and assumptions:

- We expect PPL Corp.'s liquidity sources over the next 12 months, including cash, FFO, and credit facility availability, to exceed uses by about 1.2x. Uses include necessary capital spending, working capital, debt maturities, and shareholder distributions.
- Debt maturities are manageable over the next 12 months.
- We believe liquidity sources would exceed uses by 30% even if there were a 20% decline in FFO.
- In our assessment, PPL Corp. has good relationships with its banks, and has a good standing in the credit markets, having successfully issued debt during the recent credit crisis.

In our analysis of liquidity over the next 12 months, we assume \$6.9 billion of liquidity sources, consisting of FFO and credit facility availability. We estimate liquidity uses of \$5 billion for capital spending, maturing debt, working capital, and shareholder distributions.

PPL Corp.'s credit agreements include a financial covenant requiring debt to total capitalization no greater than 65% for PPL Energy Supply and 70% for the U.S. utilities. As of June 30, 2011, the company was in compliance with the covenants.

Debt maturities are manageable through 2014, with \$500 million in 2011, \$0 in 2012, \$737 million in 2013, and \$300 million in 2014. However, in 2015, \$1.3 billion is due. We expect that the company will refinance many of these debt maturities.

### Recovery analysis

We assign recovery ratings to first mortgage bonds (FMBs) issued by investment-grade U.S. utilities, which can result in issue ratings being notched above a utility's corporate credit rating (CCR) depending on the CCR category and the extent of the collateral coverage. We base the investment-grade FMB recovery methodology on the ample historical record of nearly 100% recovery for secured bondholders in utility bankruptcies and on our view that the factors that supported those recoveries (limited size of the creditor class, and the durable value of utility rate-based assets during and after a reorganization, given the essential service provided and the high replacement cost) will persist in the future. Under our notching criteria, when assigning issue ratings to utility FMBs, we consider the limitations of FMB issuance under the utility's indenture relative to the value of the collateral pledged to bondholders, management's stated intentions on future FMB issuance, as well as the regulatory limitations on bond issuance. FMB ratings can exceed a utility's CCR by up to one notch in the 'A' category, two notches in the 'BBB'

category, and three notches in speculative-grade categories.

KU's FMBs benefit from a first-priority lien on substantially all of the utility's real property owned or subsequently acquired. Collateral coverage of about 1.5x supports a recovery rating of '1+' and an issue rating two notches above the CCR.

## Outlook

The stable outlook on KU reflects our expectation that PPL Corp.'s management will focus on its fully regulated utilities and will not increase unregulated operations beyond current levels. The outlook also reflects our expectations that cash flow protection and debt leverage measures will be appropriate for the rating. Specifically, our baseline forecast includes FFO to total debt of around 15%, debt to EBITDA between 4x and 5x, and debt leverage to total capital under 60%, consistent with our expectations for the 'BBB' rating. Given the company's mostly regulated focus, we expect that PPL Corp. will avoid any meaningful rise in business risk by reaching constructive regulatory outcomes and limit its unregulated operations to existing levels. We could lower the ratings if PPL Corp. cannot sustain consolidated financial measures of FFO to total debt of at least 12%, debt to EBITDA below 5x, and debt leverage under 62%. This could occur if market power prices remain weak due to ongoing depressed demand. Although unlikely over the intermediate term, we could raise the ratings if the business profile further strengthens and if financial measures exceed our baseline forecast on a consistent basis, including FFO to total debt in excess of 20%, debt to EBITDA below 4x, and debt to total capital around 50%.

## Related Criteria And Research

- Standard & Poor's Standardizes Liquidity Descriptors for Global Corporate Issuers, July 2, 2010
- Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Analytical Methodology, April 15, 2008
- Ratios And Adjustments, April 15, 2008
- Changes To Collateral Coverage Requirements For '1+' Recovery Ratings On U.S. Utility First Mortgage Bonds, Sept. 6, 2007



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**Attachment to KPSC Question No. 14 – Standard & Poors, *Global Credit Portal* (LKE)  
dated September 23, 2011  
Witness: Arbough**

### Summary:

# LG&E and KU Energy LLC

**Primary Credit Analyst:**

Gerrit Jepsen, CFA, New York (1) 212-438-2529; gerrit\_jepsen@standardandpoors.com

**Secondary Credit Analyst:**

Barbara A Eiseman, New York (1) 212-438-7666; barbara\_eiseman@standardandpoors.com

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Rationale

Outlook

Related Criteria And Research

## Summary:

# LG&E and KU Energy LLC

**Credit Rating:** BBB/Stable/--

## Rationale

Standard & Poor's Ratings Services bases its rating on LG&E and KU Energy LLC (LKE) on the consolidated credit profile of parent PPL Corp., which includes what we consider to be an excellent business risk profile and aggressive financial risk profile. (For more on business risk and financial risk, see "Business Risk/Financial Risk Matrix Expanded," published May 27, 2009, on RatingsDirect on the Global Credit Portal.) In the U.S., holding company PPL Corp. consists of vertically integrated utility subsidiaries Kentucky Utilities Co. (KU) and Louisville Gas & Electric Co. (LG&E). In addition, it owns transmission and distribution electric utility PPL Electric Utilities Corp. (PPELU) and PPL Energy Supply LLC, an unregulated generation subsidiary that has 10,760 megawatts of unregulated generation capacity that consists of well-located, low-cost nuclear and coal plants that are well hedged through 2012. In the U.K., PPL Corp. owns electric distribution networks Western Power Distribution (South West) PLC, and Western Power Distribution (South Wales) PLC, Western Power Distribution (West Midlands) PLC, and Western Power Distribution (East Midlands) PLC. PPL Corp.'s rating reflects a mostly regulated utility strategy that will include continuous capital spending and timely cost recovery through various regulatory mechanisms.

The excellent business risk profile incorporates PPL Corp.'s strategy as a mostly regulated public utility holding company. PPL Corp.'s numerous utilities serve 10 million electric customers in the U.K., Pennsylvania, and Kentucky, and 320,000 natural gas distribution customers in Kentucky. The U.K. wires-only distribution utilities have credit-supportive U.K. regulation and no commodity risk because nonaffiliated retail suppliers procure the electricity for retail customers. We expect these U.K. operations to contribute about 30% of PPL Corp.'s consolidated cash flow. The stability of the U.K. cash flows, along with existing utility assets in Kentucky and Pennsylvania, all of which we assess as excellent, will more than offset the business risk profile of PPL Energy's merchant generation, which we assess as satisfactory, resulting in the excellent business profile overall. We expect the merchant generation business to comprise less than 25% of pro forma consolidated cash flows.

LKE's business risk profile incorporates the strengths of subsidiaries LG&E and KU, which serve electric and natural gas customers throughout Kentucky, including Louisville and Lexington. The strengths of these utilities include relatively predictable utility operations with steady cash flows, constructive cost recovery, and relatively low rates derived from low-cost coal-fired generation. Although most of its plants burn coal, they meet current environmental requirements, and the significant amount of capital spending needed for environmental compliance through 2015 should be recoverable through rates.

The financial risk profile for LKE reflects that of PPL Corp. The consolidated financial profile, which we consider aggressive, reflects adjusted financial measures that are in line with the rating. We expect that financial measures will continue at current levels as the company incorporates full cost recovery of capital spending in operating cash flow. We expect consolidated financial measures, including ratios of debt to EBITDA, funds from operations (FFO) to total debt, and debt to capital, to remain in line with the rating. For the 12 months ended June 30, 2011, FFO to total debt was 16.5%, total debt to total capital was about 58%, and debt to EBITDA was 4.8x. After reducing cash

flow from operations by capital spending and dividends, discretionary cash flow was negative \$275 million, indicating a need for external funding. In addition, net cash flow (FFO after dividends) to capital spending was 101%. FFO interest coverage was 4.1x, and the company's dividend payout ratio was 50%. The consolidated adjustments for PPL Corp. include pension-related items, intermediate equity treatment of the junior subordinated notes, and high equity treatment of mandatory convertible securities.

## Liquidity

The intermediate holding company's liquidity position reflects that of parent PPL Corp., which we consider adequate under Standard & Poor's liquidity methodology. (We categorize liquidity in five standard descriptors. See "Standard & Poor's Standardizes Liquidity Descriptors for Global Corporate Issuers," published July 2, 2010.)

We base our liquidity assessment on the following factors and assumptions:

- We expect PPL Corp.'s liquidity sources over the next 12 months, including cash, FFO, and credit facility availability, to exceed uses by about 1.2x. Uses include necessary capital spending, working capital, debt maturities, and shareholder distributions.
- Debt maturities are manageable over the next 12 months.
- We believe liquidity sources would exceed uses by 30% even if there were a 20% decline in FFO.
- In our assessment, PPL Corp. has good relationships with its banks, and has a good standing in the credit markets, having successfully issued debt during the recent credit crisis.

In our analysis of liquidity over the next 12 months, we assume \$6.9 billion of liquidity sources, consisting of FFO and credit facility availability. We estimate liquidity uses of \$5 billion for capital spending, maturing debt, working capital, and shareholder distributions.

PPL Corp.'s credit agreements include a financial covenant requiring debt to total capitalization no greater than 65% for PPL Energy Supply and 70% for the U.S. utilities. As of June 30, 2011, the company was in compliance with the covenants.

Debt maturities are manageable through 2014, with \$500 million in 2011, \$0 in 2012, \$737 million in 2013, and \$300 million in 2014. However, in 2015, \$1.3 billion is due. We expect that the company will refinance many of these debt maturities.

## Outlook

The stable outlook on LKE reflects our expectation that PPL Corp.'s management will focus on its fully regulated utilities and will not increase unregulated operations beyond current levels. The outlook also reflects our expectations that cash flow protection and debt leverage measures will be appropriate for the rating. Specifically, our baseline forecast includes FFO to total debt of around 15%, debt to EBITDA between 4x and 5x, and debt leverage to total capital under 60%, consistent with our expectations for the 'BBB' rating. Given the company's mostly regulated focus, we expect that PPL Corp. will avoid any meaningful rise in business risk by reaching constructive regulatory outcomes and limit its unregulated operations to existing levels. We could lower the ratings if PPL Corp. cannot sustain consolidated financial measures of FFO to total debt of at least 12%, debt to EBITDA below 5x, and debt leverage under 62%. This could occur if market power prices remain weak due to ongoing depressed demand. Although unlikely over the intermediate term, we could raise the ratings if the business profile further strengthens and if financial measures exceed our baseline forecast on a consistent basis, including FFO to

total debt in excess of 20%, debt to EBITDA below 4x, and debt to total capital around 50%.

## Related Criteria And Research

- Standard & Poor's Standardizes Liquidity Descriptors for Global Corporate Issuers, July 2, 2010
- Business Risk/Financial Risk Matrix Expanded, May 27, 2009
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- Ratios And Adjustments, April 15, 2008

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**Attachment to KPSC Question No. 16 – Moody’s, *Global Credit Research* (LG&E - KU)  
dated September 26, 2011  
Witness: Arbough**



**Rating Action:** Moody's affirms LG&E & KU's ratings; outlook stable

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Global Credit Research - 26 Sep 2011

**Approximately \$4.68 billion of debt securities and bank credit facilities**

New York, September 26, 2011 — Moody's Investors Service affirmed the Baa2 senior unsecured rating and Issuer Rating of LG&E and KU Energy LLC (LKE), as well as the ratings of subsidiaries, Louisville Gas and Electric Company (LG&E: Baa1 Issuer Rating) and Kentucky Utilities Company (KU: Baa1 Issuer Rating).

Concurrent with this rating action, Moody's has assigned a Baa2 rating to LKE's planned issuance of \$250 million of senior unsecured notes and has assigned a Baa1 rating to each of LG&E's \$400 million unsecured bank credit facility and KU's \$400 million unsecured bank credit facility. The rating outlook for LKE, LG&E, and KU is stable.

**Assignments:**

..Issuer: Kentucky Utilities Co.

....Senior Unsecured Bank Credit Facility, Assigned Baa1

..Issuer: LG&E and KU Energy LLC

....Senior Unsecured Regular Bond/Debenture, Assigned Baa2

..Issuer: Louisville Gas & Electric Company

....Senior Unsecured Bank Credit Facility, Assigned Baa1

**RATINGS RATIONALE**

The rating action reflects the continued sound financial performance of utilities KU and LG&E reflecting in large part the credit supportive regulatory environment that we believe exists in Kentucky regarding the state's investor-owned electric utilities. The rating action also considers the progress that's been made by parent company PPL Corporation (PPL: Baa3 Issuer Rating) in successfully integrating both Kentucky subsidiaries. The rating action recognizes the sizeable capital spending program that LKE's subsidiaries are undertaking to address environmental compliance, and reflects our expectation that the legislative and regulatory frameworks in the state should provide the continuation of relatively stable credit metrics during this significant capital spend period. To that end, the rating action factors in our belief that parent company PPL will continue to provide equity capital over the next several years to maintain both consolidated and standalone credit quality of its operating subsidiaries. LKE's rating further incorporates the degree of structural subordination that exists at this entity including the company's planned issuance of \$250 million of senior unsecured notes.

The stable outlook considers the continued steady financial performance anticipated at LKE and its subsidiaries which is bolstered by the credit supportive regulatory environment in which the utilities operate.

In light of the sizeable capital investment program at LKE, it is unlikely that LKE and its subsidiaries would be upgraded in the near-term. Longer-term, a rating upgrade at LKE is directly dependent upon any credit improvement at both LG&E and KU which could follow if the ratio of CFO pre-WC (cash flow) to debt and retained cash flow to debt exceeds 25% and 17%, respectively, on a sustainable basis.

LKE, KU and LG&E's ratings could be downgraded if changes were made to the regulatory compact such that the ratios of each subsidiary's coverage of cash flow to debt dropped below 16%.

LKE is the parent company of KU and LG&E. LKE is wholly owned by PPL, a diversified energy holding company headquartered in Allentown, PA.

**REGULATORY DISCLOSURES**

For ratings issued on a program, series or category/class of debt, this announcement provides relevant regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides relevant regulatory disclosures in relation to the rating action on the support provider and in relation to each particular rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides relevant regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on [www.moody.com](http://www.moody.com).

Information sources used to prepare the rating are the following: parties involved in the ratings, parties not involved in the ratings, public information, and confidential and proprietary Moody's Investors Service information.

Moody's considers the quality of information available on the rated entity, obligation or credit satisfactory for the purposes of issuing a rating.

Moody's adopts all necessary measures so that the information it uses in assigning a rating is of sufficient quality and from sources Moody's considers to be reliable including, when appropriate, independent third-party sources. However, Moody's is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

Please see Moody's Rating Symbols and Definitions on the Rating Process page on [www.moody's.com](http://www.moody's.com) for further information on the meaning of each rating category and the definition of default and recovery.

Please see ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the last rating action and the rating history.

The date on which some ratings were first released goes back to a time before Moody's ratings were fully digitized and accurate data may not be available. Consequently, Moody's provides a date that it believes is the most reliable and accurate based on the information that is available to it. Please see the ratings disclosure page on our website [www.moody's.com](http://www.moody's.com) for further information.

Please see [www.moody's.com](http://www.moody's.com) for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

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Infrastructure Finance Group  
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SUBSCRIBERS: 212-553-1653

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**Attachment to KPSC Question No. 16 – Fitch Ratings, *Fitch Rates LG&E and KU Energy LLC Senior Notes ‘BBB+’ (LG&E - KU)* dated September 27, 2011**  
**Witness: Arbough**

## **FITCH RATES LG&E AND KU ENERGY LLC SENIOR NOTES 'BBB+'**

Fitch Ratings-New York-27 September 2011: Fitch Ratings has assigned a 'BBB+' rating to LG&E and KU Energy LLC's (LKE) new \$250 million issue of senior notes due 2021. The Rating Outlook is Stable. Proceeds will be used to make a return of capital to its corporate parent PPL Corp. (PPL).

### Credit Measures

The new senior notes will increase leverage to approximately 52% of total capital from about 49%; but overall credit quality is expected to remain sound. Based on the projected capital program and the Environmental Cost Recovery Mechanism (ECR), LKE consolidated interest coverage and cash flow measures should remain robust with EBITDA/interest and funds from operation plus interest/interest expected to average more than 5.0 times (x); however, LKE's consolidated leverage is expected to be high relative to its peers.

### Key Ratings Drivers

Key rating drivers include the predictable cash flow and strong credit profile of LKE's two regulated utility subsidiaries Kentucky Utilities Company [Issuer Default Rating (IDR) of 'A-' by Fitch] and Louisville Gas and Electric Co. (IDR 'A-'). The two utilities benefit from constructive regulatory policies in Kentucky that limit cash flow volatility and business risk and from the Kentucky Public Service Commission's (KPSC) track record for timely rate increases.

Constructive regulatory policies include a monthly fuel adjustment clause (FAC) and an environmental cost recovery mechanism. Regulatory statutes also permit the inclusion of construction work in progress (CWIP) in rate base.

The ECR mechanism is particularly important given the two utilities reliance on coal-fired electric generation and the substantial investment that will be required to meet the Environmental Protection Agency's (EPA) newest environmental regulations. The ECR provides for recovery of and a return on environment investments required as a result of coal combustion emissions. The ECR permits the approved environmental costs to be reflected in rates two months after incurred.

### Rising Capital Expenditures

Management has forecasted a substantial rise in capital expenditures to meet the new EPA regulations. The large investments will require on-going rate increases and equity support from parent company PPL Corp. (IDR 'BBB').

In June 2011, LG&E and KU filed an ECR plan with the KPSC requesting approval to install environmental upgrades and to recover the estimated \$2.5 billion in associated capital and operating costs. If approved, the costs are recoverable through the ECR, substantially reducing the associated financial stress generally associated with a large investment program.

The two companies also announced plans to retire three older coal-fired electric generating plants. To replace the generating capacity the LKE subsidiaries requested KPSC approval to build a 640 megawatt natural gas combined cycle generating unit and to purchase three existing simple-cycle natural gas combustion turbines. The estimated cost of the replacement generation is \$800 million.

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Applicable Criteria and Related Research:

- 'Corporate Rating Methodology' (Aug. 12, 2011);
- 'Recovery Ratings and Notching Criteria for Utilities' (May 12, 2011);
- 'Rating North American Utilities, Power, Gas and Water Companies' (May 16, 2011).

Applicable Criteria and Related Research:

Corporate Rating Methodology  
[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=647229](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=647229)  
Recovery Ratings and Notching Criteria for Utilities  
[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=648449](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=648449)  
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