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, AND FOR OTHER AUTHORIZATIONS	)))))	CASE NO. 2014-00210

ORDER

On June 23, 2014, Kentucky Power Company ("Kentucky Power") filed an application seeking Commission approval under KRS 278.300 authorizing it to issue unsecured promissory notes in the aggregate amount of $200 million. The Attorney General, by and through his Office of Rate Intervention ("AG"), requested and was granted intervention in this proceeding. Kentucky Power responded to one Request for Information from Commission Staff. On August 11, 2014, the AG filed a motion to continue the proceeding for a term beyond the 60-day statutory deadline, stating it would need the additional time in order to propound discovery on Kentucky Power's application. On August 15, 2014, Kentucky Power filed a response objecting to the AG's request for an extension. Kentucky Power further stated in its response that, if the Commission found that good cause exists for the extension, it and the AG had agreed to the procedural schedule referenced in the AG's motion and that an evidentiary hearing was not required. Kentucky Power also requested that the Commission enter an order approving the application on or before September 30, 2014, in order for Kentucky Power to have sufficient time to close the proposed lending transactions prior to the last two months of 2014. Kentucky Power averred that borrowing costs continue to be at or near a historic low, and that any delay could result in higher borrowing costs. On August 20, 2014, the Commission issued its Order approving the AG's request for an extension of the statutory deadline and establishing the procedural schedule to which the parties had agreed and which was attached to the AG's motion for continuance. Pursuant to the procedural schedule, Kentucky Power responded to one Request for Information from the AG. Pursuant to an e-mail dated September 3, 2014, the AG informed counsel for Kentucky Power and Commission Staff that it elected not to file comments in this proceeding.[1] This case now stands submitted for decision.

DISCUSSION

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, 2016. Kentucky Power states that the proposed notes will have maturities ranging from a minimum of nine months to a maximum of 60 years and 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. Up to $100 million of the proposed $200 million may be financed through Kentucky Power's Local Bank Financing Program, which will provide financing

[1] The AG's September 3, 2014 e-mail is attached as an appendix to this Order.

at pricing in line with that available through the traditional loan market.[2] Kentucky Power states that the interest rates may be fixed or variable, depending on what is most advantageous at the time of the issuance and sale of the notes. 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 any 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 it is deemed advisable.

According to Kentucky Power's application, one or more notes may be issued to its parent company, American Electric Power Company, Inc. ("AEP"), or to 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; permitting the occurrence of certain events in connection with pension plans; and may require prepayment after certain specified events, including ownership change.

[2] Application, p. 9. Kentucky Power states that the program provides investment grade lending opportunities for local banks in its service territory, diversifying and strengthening their loan portfolios, and aiding in economic development of Kentucky Power's service territory.

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 Kentucky Power 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 states that any notes may 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. Based on experience with similar financing, Kentucky Power estimates that the total issuance costs for the notes will be approximately $1.3 million.

Kentucky Power states that it may purchase outstanding securities through tender offer, 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 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.

According to Kentucky Power, the actual cost associated with the promissory notes 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.

Kentucky Power maintains that it will file a verified statement with the Commission within 30 days after the issuance of each series of the promissory notes 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.

Kentucky Power proposes to use the proceeds from the $200 million in unsecured promissory notes to fund its capital requirements in connection with its ongoing acquisition, construction, and improvement of its facilities and for its general corporate purposes. Kentucky Power provided information concerning its estimated $312.5 million capital requirements for the period 2014 through 2016 in response to Commission Staff and AG Requests for Information, along with the case numbers in which Commission Orders were issued approving any projects which required Certificates of Public Convenience and Necessity.

Kentucky Power requests authorization to enter into one or more interest rate hedging agreements from time to time through December 31, 2016, in connection with the issuance of the promissory notes. The proposed interest rate hedging arrangements could include, but are not limited to, treasury lock agreements, forwardstarting interest rate swaps, 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. Each Treasury Hedge Agreement will correspond to one or more issuances of indebtedness proposed in its Application; therefore, the aggregate corresponding principal amounts of all Treasury Hedge Agreements will not exceed $200 million on the date or dates of entering such agreements.

Kentucky Power proposes to utilize interest rate management techniques and enter into Interest Rate Management Agreements through December 31, 2016, 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. Kentucky Power 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.[3]

Because market opportunities for these interest rate management alternatives are transitory, Kentucky Power states that it must be able to execute interest rate

[3] Application, p. 8.

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.

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, 2016, up to $200 million aggregate principal amount of unsecured promissory notes in one or more new series; and (2) 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 5 below, it should include an explanation of the chosen terms of the indebtedness, including the use of fixed or variable interest rates, and reasons 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, 2016, up to $200 million aggregate principal amount of unsecured promissory notes in one or more new series is approved.

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

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

4. 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.

5. 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 and any 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. The statement shall also indicate the amount of financing secured through Kentucky Power's Local Bank Financing Program. Further, if the Notes are issued to an affiliate, as authorized by ordering paragraph 4 of this Order, then the required comparisons to AEP's cost of capital and interest rates of non-affiliate debt shall also be provided.

6. Any document filed pursuant to ordering paragraph 5 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
SEP 2 6 2014
KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

Aaron D. Greenwell
Executive Director
for

APPENDIX

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 2014-00210 DATED SEP 2 6 2014

Nguyen, Quang D (PSC)

From: Hans, Jennifer (KYOAG)
Sent: Tuesday, September 02, 2014 4:41 PM
To: Overstreet, Mark R.
Cc: Nguyen, Quang D (PSC); Cook, Larry (KYOAG)
Subject: RE: 2014-00210 Kentucky Power Financing

Dear Mark:

This is to advise you and Commission counsel that the Attorney General will not elect to file comments in this proceeding. We greatly appreciate the Commission's accommodation of our intervention and strongly believe that the limited continuance and additional discovery/data production has led to a more fully developed record upon which to evaluate the proposal.

If you have any questions regarding this matter, please do not hesitate to contact me.

Regards,

Jennifer Black Hans
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From: Overstreet, Mark R. [mailto:MOVERSTREET@stites.com]
Sent: Friday, August 15, 2014 3:35 PM
To: Hans, Jennifer (KYOAG); Ranie K Wohnhas
Cc: Cook, Larry (KYOAG); Nguyen, Quang D (PSC)
Subject: RE: 2014-00210 Kentucky Power Financing

Thanks.

Mark R. Overstreet
Member

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From: Hans, Jennifer (KYOAG) [mailto:jennifer.hans@ag.ky.gov]
Sent: Friday, August 15, 2014 3:34 PM
To: Overstreet, Mark R.; Ranie K Wohnhas
Cc: Cook, Larry (KYOAG); Nguyen, Quang D (PSC)
Subject: 2014-00210 Kentucky Power Financing

Dear Counsel:

Please find attached the Attorney General's Data Requests to Kentucky Power, which were filed with the Commission earlier today. (A Microsoft Word version is attached for the convenience of Kentucky Power.) Hard-copies have been mailed.

This pleading is filed consistent with the Agreed Scheduling Order but still subject to the Commission's decision on the Attorney General's Motion for Continuance filed on Monday, August 11, 2014, which remains pending as of the date/time of this email.

Sincerely,

Jennifer Black Hans
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