COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC 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. 2016-00345

ORDER

On October 26, 2016, Kentucky Power Company ("Kentucky Power") filed an application seeking Commission approval under KRS 278.300 authorizing it to issue and sell promissory notes of one or more series in the aggregate amount of $550 million and for other relief. Kentucky Power responded to one round of requests for information issued by Commission Staff. There are no intervenors in this proceeding. The case stands submitted to the Commission for a decision based upon the evidentiary record.

DISCUSSION

Kentucky Power proposes to issue and sell up to $550 million aggregate principal amount of unsecured promissory notes in one or more series in one or more transactions through December 31, 2018. The notes may be issued as (1) Senior Notes, or other unsecured promissory notes, (2) in connection with one or more tax-exempt financing transactions with the West Virginia Economic Development Authority ("WVEDA") and (3) in connection with Kentucky Power's Local Bank Financing Program. 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 $550 million may be financed through Kentucky Power's Local Bank Financing Program, which was approved by the Commission in Case No. 2014-00210.[1] 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.[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 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 agreements to any specific redemption provisions, including redemption premiums, will be made at the time of pricing, and that Kentucky Power may provide the notes with some form of credit enhancement if such 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

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[1] Case No. 2014-00210, *Application of Kentucky Power Company for Authority Pursuant to KRS 270.300 to Issue and Sell Promissory Notes of One or More Series, and for Other Authorizations* (Ky. PSC Sept. 26, 2014).

[2] Application, paragraph 30.

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; from creating indebtedness other than what is specified; from failing to maintain a certain financial condition; from entering into mergers, consolidations, and dispositions of assets; and from permitting the occurrence of certain events in connection with pension plan. Kentucky Power may permit the note holders to require Kentucky Power to prepay them after certain specified events, including ownership change.

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. Therefore, Kentucky Power requests that it be permitted to determine at a subsequent date whether there will be more than one series, and, if so, 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. Kentucky Power estimates, based on past experience with similar financing, that the total issuance costs for the notes will be approximately $3 million.

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 redemption. Kentucky Power indicates that it 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.

Kentucky Power maintains that it will, within 30 days after the issuance of each series of the promissory notes, file a verified statement with the Commission disclosing the date or dates of issuance, the price paid, the interest rate, the purchasers, and 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 $550 million in unsecured promissory notes to fund its capital requirements in connection with ongoing acquisition, construction, and improvement of its facilities, for its general corporate purposes, and to refinance existing notes. Specifically, Kentucky Power seeks authority to issue indebtedness and engage in financings in the amount of $85 million for its general corporate purposes and its capital requirements in connection with ongoing acquisition, construction, and improvement of its facilities[3] and to refinance the $325 million 6.0 percent Senior Note, Series E, due in 2017; the $75 million Variable Rate Local Bank Faculty Program due in 2018; and the $65 million WVEDA, Series 2014A Variable Rate Demand Note Pollution Control Bond due in 2017.

Kentucky Power requests authorization to enter into one or more interest rate hedging agreements from time to time through December 31, 2018, 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, forward-starting 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 Kentucky Power's application; the aggregate corresponding principal amounts of all Treasury Hedge Agreements will therefore not exceed, on the date or dates of entering such agreements, $550 million.

Kentucky Power proposes to utilize interest rate management techniques and enter into interest rate management agreements ("Interest Rate Management Agreements") through December 31, 2018, to allow it sufficient alternatives and flexibility to reduce its effective interest cost and manage interest cost on financings.

[3] Estimated capital requirements for 2016 through 2018 are $319 million. In response to Staff's First Request for Information, Item 5, the balance of the $319 million will be initially financed using internally supplied funds.

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 they will 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.[4]

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 in order 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

[4] Application, paragraph 24.

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, 2018, up to $550 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 of 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, 2018, up to $550 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 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), and 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.

6. Any document filed pursuant to ordering paragraph 5 herein 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

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KENTUCKY PUBLIC
SERVICE COMMISSION

ATTEST:

Taline R. Mathews

Executive Director

*Kentucky Power Company
101 A Enterprise Drive
P. O. Box 5190
Frankfort, KY 40602

*Kentucky Power Company
Kentucky Power Company
101 A Enterprise Drive
P. O. Box 5190
Frankfort, KY 40602

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