

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF LOUISVILLE GAS	)	
AND ELECTRIC COMPANY FOR (1) AN ORDER	)	
AUTHORIZING THE ISSUANCE OF SECURITIES	)	CASE NO.
AND THE ASSUMPTION OF OBLIGATIONS AND (2)	)	2018-00335
AN ORDER AMENDING AND EXTENDING	)	
EXISTING AUTHORITY WITH RESPECT TO	)	
REVOLVING LINE OF CREDIT	)	

ORDER

On October 5, 2018, Louisville Gas and Electric Company (LG&E) filed an application for authority to incur debt in the form of First Mortgage Bonds in a principal amount not to exceed \$600 million; authority to enter into interest rate hedging agreements in connection with the issuance of the First Mortgage Bonds; and authority to extend its existing revolving line of credit for up to five years from the effective date of the amendment or, alternatively, to replace those portions of the credit line that are not extended. LG&E responded to Commission Staff's First Request for Information on November 16, 2018. No requests for intervention were made in this matter and no public comments were received.

BACKGROUND

First Mortgage Bond Debt

LG&E requested authorization from the Commission to incur additional long-term debt in the form of First Mortgage Bonds in a principal amount not to exceed \$600,000,000. LG&E expects the issuance of the First Mortgage Bonds to be sold at

various times through 2018 and into 2019 in one or more underwritten public offerings, negotiated sales, or private placement transactions utilizing the proper documentation. The price, maturity date(s), interest rate(s), redemption provisions and other applicable terms, including whether the bonds have a fixed or variable interest rate, would be determined by negotiations among LG&E and the underwriters, agents or other purchasers of the First Mortgage Bonds.

LG&E would issue the First Mortgage Bonds under its Mortgage Indenture. LG&E's Mortgage Indenture and amendments thereto (Mortgage Indenture) authorize it to issue from time to time, First Mortgage Bonds of one or more series, with each series having such date, maturity date(s), interest rate(s), and other terms as may be established by a supplemental indenture executed by LG&E. All First Mortgage Bonds that would be issued under the Indenture would be secured equally and ratably by a first mortgage lien, subject to permitted encumbrances and exclusions, on substantially all of LG&E's permanently fixed properties in Kentucky.

LG&E noted that interest rates and associated issuance costs are dictated by market conditions, which are fluid. However, as of November 5, 2018, LG&E stated that the indicated rate on a 10-year, fixed-rate First Mortgage Bond was 4.091 percent and that the indicated rate on a 30-year, fixed-rate First Mortgage Bond was 3.425 percent. LG&E further stated that as of November 8, 2018, a five-year variable-rate First Mortgage Bond would have an initial interest rate of 3.102 percent, consisting of the current three-month LIBOR rate of 2.592 percent plus a risk premium of 51 basis points.<sup>1</sup> Further,

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<sup>1</sup> LG&E's Responses to Commission Staff's First Request for Information (Response to Staff's First Request), Item 15; *see also* Application at Exhibit 17 (in which the Board of Directors of LG&E authorized the issuance so long as the interest rate on the debt does not exceed 6.500 percent per annum).

based on experience with past issuances, LG&E estimated the amount of compensation to be paid to underwriters and agents for their services would not exceed 1 percent, or approximately \$500,000.<sup>2</sup>

LG&E indicated that the requested financing is needed to pay down its short-term debt balance, fund construction projects in 2018 and 2019, support ongoing needs of the business, and finance the estimated reduction in cash receipts related to the Tax Cuts and Jobs Act (TJCA).<sup>3</sup> Specifically, on November 16, 2018, LG&E stated that it had a short-term debt balance of \$191 million and a \$200 million term loan with a maturity date of October 25, 2019.<sup>4</sup> Further, it anticipates incurring approximately \$818 million in capital expenditures during the remainder of 2018 and 2019 for various projects, including the following projects for which a Certificate of Public Convenience and Necessity has been granted: Trimble County CCP Storage (Landfill – Phase I), Mill Creek Air Compliance, Trimble County CCR Rule Compliance Construction, Mill Creek CCR Rule Compliance Construction, Distribution Automation, Gas Service Lines and Riders.<sup>5</sup>

LG&E stated that the issuance of the First Mortgage Bonds would not affect its equity position or credit rating, because “[t]he issuance of First Mortgage Bonds is an exchange of short-term for long-term debt.”<sup>6</sup> However, LG&E asserted that an order denying its request would significantly reduce its liquidity, given its current short-term

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<sup>2</sup> Application, Paragraph 8.

<sup>3</sup> *Id.* at Paragraph 5.

<sup>4</sup> Response to Staff’s Requests, Item 18; Application at Paragraph 5.

<sup>5</sup> Response to Staff’s Requests, Item 1 (providing list of capital projects for which spending is anticipated in 2018 and 2019 along with the anticipated capital spending); Response to Staff’s Requests, Item 2 (identifying those projects for which a CPCN has been previously granted).

<sup>6</sup> Response to Staff’s Requests, Item 13 and 17.

obligations and restrictions on the amount of short-term debt it can incur. LG&E stated that this reduction in liquidity in turn would require it to request equity contributions from its parent company, withhold dividend payments to its parent, or severely restrict its capital expenditures to the extent that its ability to provide safe, reliable service may be jeopardized. LG&E also argued that a denial and the resulting reduction in its liquidity would “almost certainly result in the credit rating downgrade, thereby increasing costs to customers.”<sup>7</sup>

#### Interest Rate Hedging Agreements

LG&E requested authority from the Commission to enter into interest rate hedging agreements “[i]n connection with the issuance of the First Mortgage Bonds.”<sup>8</sup> LG&E explained that by requesting authority to enter to such agreements “in connection with the issuance” of the bonds that it was indicating that any such hedging agreements would be directly associated with the bonds for which authorization is being sought. LG&E stated that it is not seeking authority to enter into any such agreements that are speculative in nature or related to any other transaction.<sup>9</sup> Further, LG&E indicated that it is seeking authority to enter into interest rate hedging agreements up to the entire amount of the bonds issued.<sup>10</sup>

LG&E stated that it was requesting authority to enter into three types of interest rate hedging agreements—forward starting fixed payer interest rate swaps, treasury

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<sup>7</sup> Response to Staff’s Requests at 18.

<sup>8</sup> Application at Paragraph 10.

<sup>9</sup> Response to Staff’s Request at 7.

<sup>10</sup> *Id.*

locks, and floating rate payer interest rate swaps.<sup>11</sup> LG&E asserted that (1) forward starting fixed payer interest rate swaps would allow it to hedge against increases in interest rates, including the credit spread, from the time it enters the agreement to the time the bonds are issued; (2) treasury locks would permit LG&E to hedge against increases in treasury rates from the time it enters the agreement to the time the bonds are issued, but would not provide a hedge against changes in the credit spread; and (3) floating rate payer interest rate swaps, which would be an agreement by LG&E to swap a fixed interest rate for a variable interest rate, would reduce volatility of the value of the fixed rate bond as the change in the value of the swap should virtually offset a change in the value of the bond.<sup>12</sup>

To mitigate counterparty risks associated with interest rate hedging agreements, LG&E indicated that it would only enter into a hedging agreement with PPL Corp. (PPL) or a bank. Importantly, if it entered into a hedging agreement with PPL, its parent company, PPL would enter into the hedging agreement with a bank and would enter into a mirror agreement with LG&E. PPL would not charge LG&E any fee for this service. Further, regardless of whether LG&E entered into a hedging agreement through PPL or directly with a bank, LG&E indicated that the bank would be rated at or above A3 as defined by Moody's Investor Services or A- as defined by Standard and Poor's at the time the transaction is booked, which LG&E contended would guard against counterparty risk.<sup>13</sup>

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<sup>11</sup> Response to Staff's Request, Item 7.

<sup>12</sup> *Id.*

<sup>13</sup> Response to Staff's Request, Item 7; *see also* Response to Staff's Request, Item 12 (indicating key risks associated with hedging agreements identified by LG&E and how LG&E claimed it would guard against them).

LG&E estimated that the cost to lock in ten-year rates for six months would be approximately twelve basis points. Similarly, LG&E estimated that the cost to fix the interest rate of a variable rate bond for three years would be approximately seven basis points. However, LG&E noted that those estimates in the cost of the hedging agreements were based on market conditions at the time it made its application and that they could change based on changes in the market.<sup>14</sup>

Moreover, LG&E indicated that the overall benefits and costs of its use of interest rate hedging agreements would not be known until those agreements reach maturity.<sup>15</sup> LG&E is requesting to establish regulatory assets or liabilities to account for the losses or gains arising from the interest rate hedging agreements and to amortize those losses or gains over the remaining life of the First Mortgage Bonds.<sup>16</sup> LG&E stated that “[t]he hedging could result in higher costs or lower costs depending upon the movement of interest rates.”<sup>17</sup> However, LG&E noted that its costs of debt has remained among the lowest in its utility peer group for over a decade, which it argued demonstrates its prudent use of hedging agreements previously authorized by the Commission.<sup>18</sup>

#### Extending Term of Revolving Credit Line

LG&E requested in Case No. 2016-00361<sup>19</sup> authority to increase its existing

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<sup>14</sup> Application at Paragraph 11.

<sup>15</sup> Response to Staff’s Request, Item 10 (discussing the costs and benefits of proposed hedging agreements).

<sup>16</sup> Application at Paragraph 10

<sup>17</sup> Response to Staff’s Request, Item 10(b).

<sup>18</sup> Response to Staff’s Request, Item 11.

<sup>19</sup> Case No. 2016-00361, *Electronic Application of Louisville Gas and Electric Company for an Order Amending and Extending Existing Authority with Respect to Revolving Line of Credit* (Ky. PSC Dec. 14, 2016).

revolving line of credit or enter into new lines of credit, with a term not to exceed five years, and with a total aggregate amount of multi-year revolving credit facilities not to exceed \$500 million. In Case No. 2016-00361, LG&E requested authority to extend the term of its existing revolving line of credit for the maximum five-year term from the date of the amendment and authority to exercise additional extensions in 2017 and 2018 to lock in favorable interest rates for as long of a term as possible.<sup>20</sup> LG&E exercised that authority on January 26, 2018, such that the current term of its Credit Facility ends on January 26, 2023.<sup>21</sup>

When LG&E requested authority to exercise extensions of its credit facility in Case No. 2016-00361, it asserted that, based upon its discussions with providers of credit facilities regarding potential changes in market conditions, it believed that revolving credit facilities would no longer be available on terms as favorable as those found in LG&E's current facility.<sup>22</sup> However, LG&E asserts that the favorable market conditions that justified extending the credit facility in Case No. 2016-00361 have not materially changed. Thus, LG&E requested authority to exercise extensions of its multi-year revolving credit line in 2019 and 2020 to extend the credit facility maturity date to up to five years from the effective date of the amendment.<sup>23</sup>

LG&E argued that extending the current revolving credit facilities would allow LG&E to continue to obtain favorable short-term debt costs while avoiding higher commitment fees and related transaction costs expected in the future. LG&E asserted

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<sup>20</sup> Application at Paragraph 15.

<sup>21</sup> Application at Paragraph 14.

<sup>22</sup> Application at Paragraph 15.

<sup>23</sup> Application at Paragraph 16.

that this would provide LG&E with the flexibility to further optimize its short-term debt costs for its customers. LG&E stated that it would provide notice of each extension to the Commission within thirty days of execution.<sup>24</sup>

Although LG&E expects that all of the credit service providers will agree to extend the credit facility at the current individual or aggregate participation levels, LG&E also “request[ed] authority to amend and restate the Credit Agreement [with its current credit service providers], if necessary,” and alternative authority to enter into separate or individual revolving credit lines to replace any non-extended portion of the credit facility.<sup>25</sup> LG&E expects the extended credit facilities to be on similar terms as LG&E’s existing revolving credit and stated that the credit would be available for the same purposes for which revolving credit is currently available.<sup>26</sup> LG&E stated that the loan proceeds could be used to provide short-term financing for LG&E’s general financing needs – for example, general costs of operation or costs of LG&E’s various construction programs or other obligations – until permanent or long-term financing can be arranged. Further, LG&E asserted that the extended credit facilities could be used to provide liquidity or credit support for LG&E’s other debt – for example, ensuring that LG&E has readily available funds with which to make payments with respect to variable rate bonds that could be tendered for purchase and not remarketed. However, LG&E noted that it does not assign specific financing to any particular capital project or operating or fiscal use and

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<sup>24</sup> Application at Paragraph 16.

<sup>25</sup> Application at Paragraphs 17, 18.

<sup>26</sup> Application at Paragraph 19; *see also* Response to Staff’s Request, Items 20 and 21 (discussing the material terms LG&E anticipates changing).



does not project finance projects.<sup>27</sup>

## DISCUSSION

Having considered the evidence of record and being otherwise sufficiently advised, the Commission finds that the issuance of the First Mortgage Bonds in a principal amount not to exceed \$600 million; the use of interest rate hedging agreements and corresponding regulatory assets and liabilities; and the extension, amendment, or replacement of LG&E's existing revolving line of credit as set out in LG&E's application, are for lawful objects within the corporate purposes of LG&E's utility operations, are necessary and appropriate for and consistent with the proper performance of LG&E's service to the public and will not impair LG&E's ability to perform that service, are reasonably necessary and appropriate for such purposes, and should therefore be approved. However, the Commission notes that its approval herein is based upon statements made by LG&E in its Application and its responses to Commission Staff's First Request for Information. Thus, the Commission notes that its approval is conditioned on LG&E acting in a manner consistent with representations made in this matter, including those discussed below.

Most importantly, LG&E indicated that if it entered into any interest rate hedging agreement with an affiliate that the affiliate would be PPL Corp. (PPL), and that PPL would enter into a hedging agreement with a bank and then enter into a "mirror transaction" with LG&E. If there was no mirror transaction between PPL and the bank, then a perverse incentive would arise, because losses to LG&E would be recovered through a regulatory asset with the corresponding gain going to PPL, whereas losses to PPL would result in a

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<sup>27</sup> Application at Paragraph 18.

benefit to LG&E that would be passed along to ratepayers through a corresponding regulatory liability. Along the same lines, LG&E indicated that PPL would not charge LG&E a fee to act as an intermediary in entering into a transaction with a bank and a mirror transaction with LG&E. Thus, the Commission notes any interest rate hedging agreement with PPL must be based on a specific mirror transaction with a bank and that LG&E may not agree to pay a fee charged by PPL for acting as an intermediary between the bank and LG&E.

The Commission also notes that LG&E stated that its company policy requires that the counterparty to any interest rate hedging agreement be rated at or above A3 as defined by Moody's Investor Services or A- as defined by Standard and Poor's at the time transaction is booked. The Commission understood this statement to mean that LG&E would not enter into an interest rate hedging agreement with a bank directly or through PPL unless the bank met those standards. Thus, the Commission notes that LG&E's authority to enter into interest rate hedging agreements granted herein is subject to that condition regarding the credit rating of the counterparty regardless of any subsequent change in company policy.

IT IS THEREFORE ORDERED that:

1. LG&E is authorized to issue long-term debt in the form of First Mortgage Bonds in a principal amount not to exceed \$600 million, from the date this order is entered through December 31, 2019.
2. LG&E is authorized to enter into the interest rate hedging agreements for which approval was sought herein in connection with its issuance of the First Mortgage Bonds.

3. LG&E is authorized to establish regulatory assets or liabilities to account for the losses and gains arising from its use of the interest rate hedging agreements approved herein and to amortize the losses and gains over the remaining life of the First Mortgage Bonds as described in the application.

4. The proceeds from the transactions authorized herein shall be used only for the lawful purposes set out in the application.

5. LG&E shall, within 30 days from the date of issuance, file with the Commission a statement setting forth the date or dates of issuance of the debt authorized herein, the date of maturity, the price paid, the proceeds of such issuances, the interest rate, costs or gains from the use of hedging agreements, and all fees and expenses, including underwriting discounts or commissions or other compensation, involved in the issuance and distribution. LG&E shall also file documentation showing the quotes that it relied upon to determine the lowest interest rate.

6. LG&E is authorized to extend the term of its existing revolving line of credit and the total aggregate amount of multi-year revolving credit facilities shall not exceed \$500 million.

7. The proceeds from the transactions authorized herein shall be used only for the lawful purposes set out in the application.

8. LG&E shall agree only to such terms and prices that are consistent with the parameters set out in its application.

9. LG&E is authorized to replace alternatively any credit facility not extended with similar multi-year revolving credit facilities for the same term.

10. LG&E is authorized to exercise extensions in 2019 and 2020, respectively,

to extend the facility maturity dates to five years from the date of the amendment.

11. LG&E shall, within 30 days from the date of issuance, file with the Commission a statement setting forth the date or dates of issuance of the securities authorized herein, the date of maturity, the price paid, the proceeds of such issuances, the interest rate, costs or gains from the use of hedging agreements, and all fees and expenses, including underwriting discounts or commissions or other compensation, involved in the issuance and distribution. LG&E shall also file documentation showing the quotes that it relied upon to determine the lowest interest rate.

12. Any documents filed pursuant to ordering paragraphs 5 and 11 of this Order shall reference the number of this case and shall be retained in the utility's general correspondence file.

13. Nothing contained herein shall be construed as a finding of value for any purpose or as a warranty on the part of the Commonwealth of Kentucky or any agency thereof as to the debt authorized herein.

By the Commission

ENTERED  
DEC 03 2018  
KENTUCKY PUBLIC  
SERVICE COMMISSION

ATTEST:



Executive Director

Case No. 2018-00335

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