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October 10, 2006

**HAND DELIVERY**

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OCT 10 2006

PUBLIC SERVICE  
COMMISSION

Elizabeth O'Donnell  
Executive Director  
Public Service Commission of Kentucky  
211 Sower Boulevard  
Frankfort, Kentucky 40602

**Re: Kentucky Utilities Company  
Case No. 2006-00390**

Dear Ms. O'Donnell:

Enclosed for filing please find the original and ten copies of the Response of Kentucky Utilities Company to Commission Staff's Initial Data Request dated October 3, 2006. An extra copy of the Response is enclosed to be file stamped and returned to the undersigned.

Please do not hesitate to contact me if you have any questions or require additional information.

Very truly yours,

J. Wade Hendricks

JWH/dvg  
Enclosures

cc: Daniel Arbough  
Kent W. Blake  
Rick Lovekamp  
John Fendig, Esq.  
Allyson K. Sturgeon, Esq.  
Roger Hickman  
Elliott Horne

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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OCT 10 2006

In the Matter of:

PUBLIC SERVICE  
COMMISSION

THE APPLICATION OF KENTUCKY UTILITIES )  
COMPANY FOR AN ORDER AUTHORIZING )  
THE ISSUANCE OF SECURITIES AND THE )  
ASSUMPTION OF OBLIGATIONS )

CASE NO. 2006-00390

RESPONSE OF  
KENTUCKY UTILITIES COMPANY TO  
COMMISSION STAFF'S INITIAL DATA REQUEST

DATED: OCTOBER 3, 2006

FILED: OCTOBER 10, 2006

**KENTUCKY UTILITIES COMPANY**

**Response to Commission Staff's  
Initial Data Request Dated October 3, 2006**

**Case No. 2006-00390**

**Question No. 1**

**Witness: Kent W. Blake, Director, State Regulation and Rates/ Counsel**

Q-1. Will KU be in compliance with KRS 278.2213(11) if it discloses to Fidelity the lowest interest rate quoted by another financial institution and then allows Fidelity to match that lowest-quoted interest rate? Explain in detail your response.

A-1. Yes, KU is in compliance with KRS 278.2213(11) in disclosing to Fidelity the lowest interest rate quoted by a financial institution and then allowing Fidelity to match that rate. The purpose of the loan methodology at issue is, and has been, to use the cash available to E.ON to provide the best possible terms to the utilities without any closing costs. That methodology comports with the statutory purposes of KRS 278.300 and has, in fact, been approved by the Commission repeatedly.<sup>1</sup>

Subsection (11) of KRS 278.2213 prohibits only “undue” preferential treatment to a nonregulated affiliate. The circumstances here do not fit any dictionary definition of “undue.”<sup>2</sup> It is not “undue” for a utility to provide

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<sup>1</sup> See, e.g., *The Application of Kentucky Utilities Company for an Order Authorizing the Issuance of Securities and the Assumption of Obligations*, PSC Case No. 2003-00059 (April 30, 2003) (“April 2003 KU Order”); *The Application of Louisville Gas and Electric Company for an Order Authorizing the Issuance of Securities and the Assumption of Obligations*, PSC Case No. 2003-00058 (April 30, 2003); *The Application of Kentucky Utilities Company for an Order Authorizing the Issuance of Securities and the Assumption of Obligations*, PSC Case No. 2006-00155 (May 22, 2006); *The Application of Kentucky Utilities Company for an Order Authorizing the Issuance of Securities and the Assumption of Obligations*, PSC Case No 2005-00117 (May 10, 2005); *The Application of Kentucky Utilities Company for an Order Authorizing the Issuance of Securities and the Assumption of Obligations*, PSC Case No. 2003-00301 (September 22, 2003); *The Application of Louisville Gas and Electric Company for an Order Authorizing the Issuance of Securities and the Assumption of Obligations*, PSC Case No. 2003-00300 (September 22, 2003).

<sup>2</sup> The word “undue” is defined as “1. unwarranted; excessive; “ “2. inappropriate; unjustifiable; improper;” or “3. not owed or currently payable.” *Dictionary.com Unabridged (v 1.0.1)*; Based on *Random House Unabridged Dictionary* (Random

information that will result in low-cost financing on reasonable terms and conditions – particularly as the Commission itself has directly addressed, and approved, the very method of determining the interest rate for loans obtained by KU from Fidelity Corporation that is at issue here:

The Commission’s intent is that KU should obtain an interest rate that is no higher than it would otherwise pay if there were no financing available through Fidelity. ... If E.ON, through Fidelity, is able to offer a rate lower than that available to KU from an external sources, the fact that the rate is an average of rates available to E.ON is acceptable to the Commission. ... [W]e will approve KU borrowing at the lower of (a) the average of the interest rates available to E.ON or (b) the lowest interest rate available to KU.

April 2003 KU Order, at 2.

It is not “undue” – or “unwarranted,” “excessive,” “inappropriate,” “unjustifiable,” or “improper” - for KU to disclose information in a manner and for a purpose that have been expressly approved by the Commission. Thus, its disclosure of the subject information to Fidelity cannot, either legally or logically, be considered “undue” preferential treatment.

Next, KRS 278.2213(11) prohibits only that “undue” preferential treatment that is to the “detriment” of a “competitor.” Disclosure of the rates quoted by investment banking houses cannot properly be considered “detrimental” to a “competitor” for a number of reasons. First, it is not “detrimental” to an investment bank to disclose the interest rates it quotes. Transparency in such matters is to be expected, and quoted rates are not given to KU in confidence.

Moreover, Fidelity simply is not a “competitor” of the investment banks in the sense contemplated by KRS 278.2213. It does not market services to the public in competition with investment banks in the manner contemplated by the statute. Subsection after subsection of KRS 278.2213 makes it clear that the protection for utility “competitors” that it provides pertains only to situations in which a utility could leverage its strong market presence to injure competitors who market services *to third parties*. For example, subsection (12) requires a utility, when asked by a customer to recommend a nonregulated service provider (e.g., a plumber) to respond not only by recommending itself or an affiliate, but also by informing the customer that competing suppliers for that service exist. Subsection (13) similarly seeks to limit the utility’s market power by requiring it to use a disclaimer when its own well-known trademarks are used by itself or by an affiliate to advertise nonregulated services.

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House, Inc. 2006). Definition 3 clearly does not apply in this instance; and 1 and 2 are equally inapplicable under the circumstances here.

In short, the clear and express language of the statute demonstrates no objective whatsoever to use the machinery of state government to protect investment banking firms from utility affiliates that engage solely in intra-system loans – particularly as KRS 278.300, which enables the Commission to ensure that utilities obtain financing on reasonable terms and conditions, is part and parcel of KRS Chapter 278's statutory scheme pursuant to which the Commission is to ensure that utility rates are reasonable.

**KENTUCKY UTILITIES COMPANY**

**Response to Commission Staff's  
Initial Data Request Dated October 3, 2006**

**Case No. 2006-00390**

**Question No. 2**

**Witness:**

Daniel K. Arbough, Director, Corporate Finance and Treasurer

- Q-2. Assuming that Fidelity purchases KU's debt at an interest rate that is equal to the lowest rate available to KU from a non-affiliate, explain in detail any advantages to KU from issuing debt to Fidelity rather than to a non-affiliate.
- A-2. The methodology at issue here leads to competitively priced debt with no closing costs to KU and its customers. Thus, there are both practical and economic benefits in issuing debt to Fidelity rather than to a non-affiliated banking institution. Specifically, unlike financings through non-affiliated investment banks, KU does not have to pay for costs relating to legal and trustee fees, or for printing and other services. In addition, the transaction is completed more expeditiously, allowing KU to take advantage of favorable market conditions more readily.

**KENTUCKY UTILITIES COMPANY**

**Response to Commission Staff's  
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**Case No. 2006-00390**

**Question No. 3**

**Witness: Kent W. Blake, Director, State Regulation and Rates**

- Q-3. If the Commission grants KU the relief requested in this case, is KU willing to commit to continue to file with the Commission all of the information that it currently files with the Federal Energy Regulatory Commission ("FERC") on the quarterly Form 3Q and Form 60 in the event that FERC reduces its filing requirements in the future?
- A-3. KU commits to continue to provide the Commission with copies of KU's three quarterly FERC Form 3Q and E.ON U.S. Services Inc.'s annual FERC Form 60 as filed with FERC until such time as the Kentucky Public Service Commission determines that such information is no longer necessary or required.

# KENTUCKY UTILITIES COMPANY

## Response to Commission Staff's Initial Data Request Dated October 3, 2006

Case No. 2006-00390

### Question No. 4

**Witness: Valerie L. Scott, Controller/ Counsel**

Q-4. If the Commission grants KU the relief requested in this case, will KU remain subject to all existing Securities and Exchange Commission ("SEC") requirements other than the requirements to file the 10-K, the 10-Q, and the 8-K reports? If no, explain fully each existing requirement that would no longer be applicable to KU.

A-4. No. The federal securities laws that are most directly relevant to KU are the Securities Act of 1933 (the "1933 Act") and the Securities Exchange Act of 1934 (the "1934 Act"). Generally speaking, the 1933 Act governs the registration process related to the sale of securities to the public and the 1934 Act governs the operations of the public securities markets and the ongoing reporting obligations of public companies. A number of the accounting, disclosure and corporate governance provisions of the Sarbanes-Oxley Act also have been implemented through the 1934 Act. Certain elements of the Trust Indenture Act also cross-reference the 1934 Act. The primary purpose of the 1933 Act and the 1934 Act is promoting the orderly operation of the securities markets and the protection of investors. Because KU is a wholly-owned subsidiary and has no securities trading in the public markets and no public investors, KU will not be subject to direct regulation by the SEC. Consequently, any accounting, corporate responsibility or reporting obligations that KU had under the 1934 Act, such as auditor independence, internal controls, filing annual, quarterly and current reports on Forms 10-K, 10-Q and 8-Ks and filing of beneficial ownership statements by officers and directors, will no longer apply.<sup>3</sup>

It is important to note that although KU will not be subject to direct regulation under the 1934 Act, as a subsidiary of a public company (E.ON AG), KU is, and will continue to be, indirectly subject to many of the reporting obligations under the 1934 Act to the extent information about KU is contained in E.ON AG's filings. Similarly, because E.ON AG is subject to the Sarbanes-Oxley Act provisions regarding auditor independence and internal controls, KU is complying and will necessarily have to comply with these provisions to the extent applicable for E.ON AG to remain in compliance in the future. It is also important to note

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<sup>3</sup> To the extent that in the future KU desires to engage in publicly-registered sales of its securities, it will be subject to all of the applicable provisions of the 1933 Act and following such sale will likely once again be subject to reporting obligations under the 1934 Act.



that if this application is granted, KU's financial statements and compliance with internal controls will remain subject to review and audit by independent outside qualified auditors who will render an annual opinion on these statements. KU's annual audited financial statements will continue to be provided to the Kentucky Commission going forward.

**KENTUCKY UTILITIES COMPANY**

**Response to Commission Staff's  
Initial Data Request Dated October 3, 2006**

**Case No. 2006-00390**

**Question No. 5**

**Witness: John R. McCall, Executive Vice President, General Counsel and  
Corporate Secretary**

Q-5. If the Commission grants KU the relief requested in this case, is KU willing to commit to file with the Commission a report of each and every material event that would otherwise be reportable to the SEC on Form 8-K within 4 business days after occurrence of the event? If yes, provide the name and title of the officer of KU who will be responsible for both: (a) ensuring that the report of each material event is filed with the Commission within 4 business days; and (b) signing the report.

A-5.

KU commits to providing the Commission with a report of material events that would otherwise be clearly reportable to the SEC on Form 8-K. However, because current SEC safe-harbor rules actually authorize numerous 8-K events to be provided to the SEC via quarterly 10-Q's rather than in a separate 8-K reports following occurrence of the event, KU proposes that such material events be reported to the Commission on a monthly basis. This timing will provide the Commission with more current information than if the information were contained in KU's quarterly SEC filings.

KU's Executive Vice President, General Counsel and Corporate Secretary, currently John R. McCall, would be responsible for ensuring the reports are filed, and for signing the reports. In instances of absence, travel or other unavailability, delegates or designees of Mr. McCall may file the monthly reports.