an e·on company

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November 30, 2006

**Re: The Application of Kentucky Utilities Company for an Order Authorizing the Issuance of Securities and the Assumption of Obligations – *Case No. 2006-00390***

Dear Ms. O'Donnell:

Enclosed please find an original and five (5) copies of the Response of Kentucky Utilities Company to the Commission Staff's First Data Request dated November 20, 2006 in the above-referenced docket.

Should you have any questions concerning the enclosed, please do not hesitate to contact me.

Sincerely,

Rick E. Lovekamp

cc: Parties of Record

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

RECEIVED

NOV 30 2006

PUBLIC SERVICE
COMMISSION

In the Matter of:

| | | |
|---|---|---|
| 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**
**FIRST DATA REQUEST OF COMMISSION STAFF**
**DATED NOVEMBER 20, 2006**

FILED: NOVEMBER 30, 2006

# KENTUCKY UTILITIES COMPANY

## CASE N0. 2006-00390

## Response to First Data Request of Commission Staff
## Dated November 20, 2006

## Question No. 1

## Witness: Daniel K. Arbough

Q-1. KU's Application, Exhibit 5, presents a financial analysis of the proposal to refinance $54 million of tax-exempt secured bonds by issuing tax-exempt unsecured debt. Provide a revised financial analysis that reflects both the proposed $54 million refinancing and the anticipated issuance of $1 billion of debt over the next 5 years, assuming KU issues 30-year secured bonds at the interest rate differential discussed in KU's response to the Commission's October 19, 2006 Order, Item No. 6.

A-1. As requested above, a revised financial analysis is attached.

The analysis suggests that there would be a possible net cost to the Company of $0.5 million. However, the assumption that KU issues only 30-year secured bonds for all new debt is unreasonable. KU's response to the Commission's October 19, 2006 Order, Item No. 6 provided two estimates using prices for ten-year unsecured bonds and thirty-year unsecured bonds for purposes of evaluating whether the Best Rate Method would produce a lower interest rate when compared to issuing debt secured by first mortgage lien. While the selection of the ten-year and thirty-year terms was based on KU's experience, the issuance of only 30-year secured bonds for all of KU's debt requirements is not consistent with KU's historical practice and is not a prudent business practice. Historically, out of the nine KU loans obtained from Fidelia, only one had a maturity of 30 years; and the other loans range in maturities of 2 to 10 years.[1] It is the Company's business practice when issuing debt to finance capital needs to utilize a range of maturities and term structures that are reflective of current operating and market conditions and anticipated cash flow requirements. Thus the possibility of the $0.5 million cost to the Company is only a remote contingency.
Please note that the thirty year rates quoted in the response to the Commission's October 19, 2006, Item No. 6 are high for E.ON AG because 30 year bonds are

[1] While KU has issued many 30-year tax exempt bonds to take advantage of this low cost funding source for the maximum tenor allowed, these evidences of indebtedness are not comparable to the debt at issue in this proceeding.

Prior to the LG&E/KU merger, taxable first mortgage bonds were issued for a variety of maturities ranging from 10 to 30 years. The Fidelia debt however is the only recent benchmark available because there has not been any other taxable debt issued publicly since the LG&E/KU merger.

quite uncommon in Europe. As a result, the rate includes a premium to entice investors into a longer term maturity. The analysis reflects the highest possible cost assuming KU obtains 30 year loans for the entire anticipated $1 billion of debt. However, as discussed above, the assumption that KU would obtain only 30 year term loans is not reasonable. Given KU's business practice of using a prudent mix of maturities and the significant administrative benefits realized from the transaction, the net cost should be lower and the overall transaction should not be detrimental to the public interest.

KU acknowledges that the Commission's approval of this application has no implications for ratemaking purposes.

**KENTUCKY UTILITIES**

PRESENT VALUE ANALYSIS

| Date | Increase in Interest Charges and Ins Premium (1) | Additional Debt Expense Amortization (2) | Interest Savings due to Maturity Extension (3) | Interest Differential on Anticipated Borrowings (4) | Adminstrative Savings (6) | Underwriting, Defeasance and Issue Expenses (5) | Taxes | Net Periodic (Cost) or Savings | Present Value Factor | Present Value SAVINGS |
|---|---|---|---|---|---|---|---|---|---|---|
| 01-Jan-07 | $ - | $ - | $ - | $ - | $ - | $ (601,194) | $ - | $ (601,194) | 1.0000 | $ (601,194) |
| 01-Jan-08 | $ (154,330) | $ (23,043) | $ - | $ (52,950) | $ 267,500 | | $ (15,005) | $ 45,215 | 0.9259 | $ 41,865 |
| 01-Jan-09 | $ (154,330) | $ (23,043) | $ - | $ (139,650) | $ 275,525 | | $ 16,750 | $ (1,705) | 0.8573 | $ (1,462) |
| 01-Jan-10 | $ (154,330) | $ (23,043) | $ - | $ (195,900) | $ 283,791 | | $ 36,117 | $ (30,322) | 0.7938 | $ (24,070) |
| 01-Jan-11 | $ (154,330) | $ (23,043) | $ - | $ (244,650) | $ 292,304 | | $ 52,358 | $ (54,318) | 0.7350 | $ (39,925) |
| 01-Jan-12 | $ (154,330) | $ (23,043) | $ - | $ (312,150) | $ 301,074 | | $ 76,063 | $ (89,343) | 0.6806 | $ (60,806) |
| 01-Jan-13 | $ (154,330) | $ (23,043) | $ - | $ (353,400) | $ 310,106 | | $ 89,067 | $ (108,557) | 0.6302 | $ (68,409) |
| 01-Jan-14 | $ (154,330) | $ (23,043) | $ - | $ (353,400) | $ 319,409 | | $ 85,312 | $ (103,009) | 0.5835 | $ (60,105) |
| 01-Jan-15 | $ (154,330) | $ (23,043) | $ - | $ (353,400) | $ 328,991 | | $ 81,444 | $ (97,294) | 0.5403 | $ (52,565) |
| 01-Jan-16 | $ (154,330) | $ (23,043) | $ - | $ (353,400) | $ 338,861 | | $ 77,461 | $ (91,408) | 0.5002 | $ (45,727) |
| 01-Jan-17 | $ (154,330) | $ (23,043) | $ - | $ (353,400) | $ 349,027 | | $ 73,357 | $ (85,346) | 0.4632 | $ (39,532) |
| 01-Jan-18 | $ (154,330) | $ (23,043) | $ - | $ (353,400) | $ 359,498 | | $ 69,131 | $ (79,101) | 0.4289 | $ (33,925) |
| 01-Jan-19 | $ (154,330) | $ (23,043) | $ - | $ (353,400) | $ 370,283 | | $ 64,778 | $ (72,669) | 0.3971 | $ (28,858) |
| 01-Jan-20 | $ (154,330) | $ (23,043) | $ - | $ (353,400) | $ 381,391 | | $ 60,294 | $ (66,045) | 0.3677 | $ (24,284) |
| 01-Jan-21 | $ (154,330) | $ (23,043) | $ - | $ (353,400) | $ 392,833 | | $ 55,676 | $ (59,221) | 0.3405 | $ (20,162) |
| 01-Jan-22 | $ (154,330) | $ (23,043) | $ - | $ (353,400) | $ 404,618 | | $ 50,920 | $ (52,193) | 0.3152 | $ (16,453) |
| 01-Jan-23 | $ (154,330) | $ (23,043) | $ - | $ (353,400) | $ 416,756 | | $ 46,020 | $ (44,954) | 0.2919 | $ (13,122) |
| 01-Jan-24 | $ (154,330) | $ (23,043) | $ - | $ (353,400) | $ 429,259 | | $ 40,974 | $ (37,497) | 0.2703 | $ (10,134) |
| 01-Jan-25 | $ (154,330) | $ (23,043) | $ 707,400 | $ (353,400) | $ 442,137 | | $ (249,748) | $ 392,058 | 0.2502 | $ 98,112 |
| 01-Jan-26 | $ (154,330) | $ (23,043) | $ 707,400 | $ (353,400) | $ 455,401 | | $ (255,102) | $ 399,969 | 0.2317 | $ 92,678 |
| 01-Jan-27 | $ (154,330) | $ (23,043) | $ 707,400 | $ (353,400) | $ 469,063 | | $ (260,616) | $ 408,116 | 0.2145 | $ 87,561 |
| 01-Jan-28 | $ (140,867) | $ (15,362) | $ 531,035 | $ (353,400) | $ 483,135 | | $ (203,645) | $ 316,257 | 0.1987 | $ 62,826 |
| 01-Jan-29 | $ (100,330) | $ - | $ - | $ (353,400) | $ 497,629 | | $ (17,719) | $ 26,180 | 0.1839 | $ 4,816 |
| 01-Jan-30 | $ (100,330) | $ - | $ - | $ (353,400) | $ 512,558 | | $ (23,744) | $ 35,083 | 0.1703 | $ 5,975 |
| 01-Jan-31 | $ (100,330) | $ - | $ - | $ (353,400) | $ 527,934 | | $ (29,951) | $ 44,254 | 0.1577 | $ 6,979 |
| 01-Jan-32 | $ (53,260) | $ - | $ - | $ (353,400) | $ 543,772 | | $ (55,342) | $ 81,771 | 0.1460 | $ 11,940 |
| 01-Jan-33 | $ - | $ - | $ - | $ (353,400) | $ 560,086 | | $ (83,423) | $ 123,262 | 0.1352 | $ 16,665 |
| 01-Jan-34 | $ - | $ - | $ - | $ (353,400) | $ 576,888 | | $ (90,205) | $ 133,283 | 0.1252 | $ 16,685 |
| 01-Jan-35 | $ - | $ - | $ - | $ (353,400) | $ 594,195 | | $ (97,191) | $ 143,604 | 0.1159 | $ 16,646 |
| 01-Jan-36 | $ - | $ - | $ - | $ (353,400) | $ 612,021 | | $ (104,386) | $ 154,235 | 0.1073 | $ 16,554 |
| 01-Jan-37 | $ - | $ - | $ - | $ (353,400) | $ 630,381 | | $ (111,797) | $ 165,185 | 0.0994 | $ 16,416 |
| 01-Jan-38 | $ - | $ - | $ - | $ (247,500) | $ 649,293 | | $ (162,174) | $ 239,619 | 0.0920 | $ 22,049 |
| 01-Jan-39 | $ - | $ - | $ - | $ (180,000) | $ 668,771 | | $ (197,280) | $ 291,491 | 0.0852 | $ 24,835 |
| 01-Jan-40 | $ - | $ - | $ - | $ (135,000) | $ 688,835 | | $ (223,542) | $ 330,293 | 0.0789 | $ 26,056 |
| 01-Jan-41 | $ - | $ - | $ - | $ (82,500) | $ 709,500 | | $ (253,073) | $ 373,927 | 0.0730 | $ 27,314 |
| | ($3,581,717) | ($476,230) | $2,653,235 | ($10,425,300) | $15,442,822 | ($601,194) | $ (1,458,220) | $2,029,626 | | ($544,763) |

## *Assumptions*

(1) Reflects an increase in interest charges related to the non-insured floating rate debt of $87.1 million and insurance premium related to insured debt of $96 million through maturity.

| | | Amount | Maturity | Increase | |
|---|---|---|---|---|---|
| Interest Increase | | $ 20,930,000 | 2/1/2032 | $ 20,930 | |
| | | $ 2,400,000 | 2/1/2032 | $ 2,400 | |
| | | $ 2,400,000 | 2/1/2032 | $ 2,400 | |
| | | $ 7,400,000 | 2/1/2032 | $ 7,400 | |
| | | $ 54,000,000 | 8/1/2028 | $ 54,000 | |
| | 0.100% | $ 87,130,000 | | $ 87,130 | annually |
| Ins Premium Increase | 0.070% | $ 96,000,000 | 10/1/2032 | $ 67,200 | annually |

(2) Reflects the additional debt amortization related to the $54 million refunding through maturity August 1, 2028.

(3) Interest Savings due maturity extension. 1.310% $ 54,000,000 707,400 annually

(4) Interest differential on the anticipated borrowings over the next 5 years assuming borrowings occur at the half year point: 0.03%

| | 2007 | 2008 | 2009 | 2010 | 2011 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| L-T Borrowings | $ 353,000,000 | $ 225,000,000 | $ 150,000,000 | $ 175,000,000 | $ 275,000,000 | | $ 1,178,000,000 |
| Cumulative Interest | $ 52,950 | $ 139,650 | $ 195,900 | $ 244,650 | $ 312,150 | $ 353,400 | |

(5) Defeasance Costs $ 100,000

| | | | |
|---|---|---|---|
| New Bond Issuance | | $ 54,000,000 | |
| Bond Issuance Costs | | $ 501,194 | |
| Bond Issue Costs | | | 0.93% |
| Underwriting | $ 189,000 | | 0.35% |
| Bond Counsel | $ 80,000 | | 0.15% |
| Company Counsel | $ 93,000 | | 0.17% |
| Underwriters Counsel | $ 42,194 | | 0.08% |
| Ratings | $ 40,000 | | 0.07% |
| Printing | $ 5,000 | | 0.01% |
| Trustee Counsel | $ 6,000 | | 0.01% |
| Accountants | $ 40,000 | | 0.07% |
| Trustee | $ 6,000 | | 0.01% |
| Issuance costs | $ 312,194 | | 0.58% |

(6) Administrative Savings $267,500
Annual Inflationary Rate 3.00%
From January 1, 2007 to Maturity 261.0

M I S C E L L A N E O U S

Tax rate 40.363%

Discount rate 8.00%

**KENTUCKY UTILITIES COMPANY**

**CASE N0. 2006-00390**

**Response to First Data Request of Commission Staff**
**Dated November 20, 2006**

**Question No. 2**

**Witness: Daniel K. Arbough**

Q-2. KU's Application, page 8, states that, "The Carroll County 1994 Series A Bonds are currently redeemable at 100% of par. . . ." However, KU's response to the Commission's October 19, 2006 Order, Item No. 4, includes drafts of a loan agreement and indenture of trust, both of which provide on page 2 that, "[T]he Refunded 1994 Series A Bonds are by their terms currently subject to redemption at the option of the Issuer in whole or part on any date, at the price of 102% of the principal amount thereof. . . ." Explain in detail the apparent discrepancy between the statements in KU's application and those in the 2006 loan agreement and indenture of trust.

A-2. The 2006 loan agreement and indenture of trust in connection with the Carroll County 1994 Series A Bonds in response to the Commission's October 19, 2006 Order, Item No. 4 were discussion drafts based on prior issuances. The final agreements will reflect the Carroll County 1994 Series A Bonds are currently redeemable at 100% of par, plus accrued interest to the date of redemption.