

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF KENERGY CORP. FOR)	
AUTHORIZATION TO ASSUME OBLIGATIONS)	CASE NO.
OR LIABILITIES IN RESPECT TO EVIDENCES)	2007-00556
OF INDEBTEDNESS)	

O R D E R

On December 21, 2007, Kenergy Corp. (“Kenergy”) submitted an application to the Commission requesting authority to utilize interest rate management products¹ in conjunction with a \$31,622,000 loan from the Rural Utilities Service (“RUS”).² Kenergy plans to use an interest rate management product for a portion of the RUS loan where the loan funds do not exceed \$5,500,000. The interest rate management product transaction will be with CoBank, ACB (“CoBank”). In the alternative, Kenergy requested the Commission to find that authorization was not required for the proposed interest rate management product transactions.

Kenergy further requested that if the Commission finds that authorization for these transactions is required, the Commission authorize the use of interest rate

¹ Interest rate management products include interest rate swaps, interest rate caps, interest rate floors, interest rate collars, treasury locks, and forward rate agreements.

² The RUS loan, which is exempted from Commission approval under KRS 278.300, will finance Kenergy’s 2007-2010 Work Plan. The Commission granted Kenergy a Certificate of Public Convenience and Necessity for the 2007-2010 Work Plan in Case No. 2007-00453, Application of Kenergy Corp. for a Certificate of Public Convenience and Necessity for the 2007-2010 Work Plan, final Order dated March 28, 2008.

management products with all future loans and that the products would be provided by CoBank or other entities selected by Kenergy.

A review of the application revealed that it did not meet the minimum filing requirements set forth in 807 KAR 5:001, Section 2(2), and a notice of the filing deficiency was issued. Kenergy submitted additional information to correct the deficiencies on January 17, 2008, and the application was accepted for filing on that date.

Kenergy has determined that it would be desirable to manage interest rate risk on future loans and its board of directors adopted a resolution authorizing the use of various interest rate management products. However, the board of directors limited the use of these products such that at no single time, without prior board approval, would the aggregate amount of funds covered by all interest rate management products exceed \$5,500,000.³ Kenergy indicated that if it was satisfied with its experience with managing interest rate risk, it may want to increase the amount of funds covered by interest rate management products and may deal with entities other than CoBank.⁴ Kenergy stated that determining its satisfaction with managing interest rate risk would depend on whether it could obtain interest rates that are less than the levels factored into its budget and financial forecasts.⁵

³ Application Exhibit 1.

⁴ Application at 2.

⁵ Response to the Commission Staff's First Data Request dated February 22, 2008, Item 3(a).

Kenergy reviewed the various interest rate management products available and concluded that a treasury lock was the most appropriate product. The fixed interest rate on the pending RUS loan is based on long-term Treasury rates at the time that the funds are to be advanced. Using a treasury lock allows the borrower to lock in the interest rate today and remove the risk of rising interest rates. There are no upfront premiums or fees for entering into a treasury lock with CoBank.⁶ If the selected 30-year Treasury yield rises above the locked rate, then CoBank would pay Kenergy the present value for the full amount of the upward movement in rates. If the selected 30-year Treasury yield falls, then Kenergy would pay CoBank the present value for the full amount of the downward movement in rates.⁷

Based on a review of the record and being otherwise sufficiently advised, the Commission finds that while evidences of indebtedness that are subject to the supervision or control of an agency of the federal government are exempt from our jurisdiction pursuant to KRS 278.300(10), the rate management products proposed here are not subject to a federal agency's supervision or control. Kenergy has offered no arguments to support a finding that its proposed transaction is exempt from the prior approval requirement set forth in KRS 278.300(1). Therefore, the Commission finds that KRS 278.300 applies to the issuance of interest rate management products that are not under the supervision or control of a federal agency.

The Commission believes it is reasonable for Kenergy to attempt to manage its interest rate risk on its long-term debt. While investor-owned utilities have been utilizing

⁶ Id., Item 4(a).

⁷ Application, Exhibit 2, at 4.

interest rate management products for some time, Kenergy is the first electric distribution cooperative to seek approval to use such products. Given the pricing of the RUS debt and the alternatives available, the Commission agrees with Kenergy that treasury locks are the most reasonable option. The Commission finds that Kenergy's request to enter into a treasury lock with CoBank for up to \$5,500,000 on a loan advance from the pending \$31,622,000 RUS loan is reasonable and should be approved.

Further, the Commission finds it reasonable and will authorize Kenergy to enter into additional treasury locks with CoBank for future loan advances from the pending \$31,622,000 RUS loan. Kenergy will borrow the RUS loan funds through a series of loan advances over time depending on the level of expenditures it has incurred in conjunction with its 2007-2010 Work Plan. While Kenergy is being granted the authority to enter into additional treasury locks with CoBank on subsequent loan advances from this particular RUS loan, the Commission stresses that Kenergy will be under no obligation to do so. With each subsequent loan advance, Kenergy will need to determine whether entering into a treasury lock with CoBank will be financially beneficial.

While it is reasonable for Kenergy to enter into additional treasury locks with CoBank for future loan advances associated with the pending \$31,622,000 RUS loan, the Commission finds it unreasonable to grant Kenergy's request to approve the use of interest rate management products with all future loans, provided by CoBank or other entities selected by Kenergy. Such blanket authorization has not been granted to any other utility. With each new debt issuance, the investor-owned utilities seek approval of

applicable interest rate management products in conjunction with their financing applications. Since the interest rate management products are subject to prior approval under KRS 278.300, the blanket authorization requested by Kenergy would not provide the Commission with sufficient details to determine whether or not the selected products are reasonably necessary and appropriate for each evidence of indebtedness.

Further, the Commission finds Kenergy's approach to determining its satisfaction with interest rate management products and whether to increase the aggregate amount of funds covered by such products is neither appropriate nor reasonable. Since Kenergy incorporates its expectations about future interest rates in its budgeting process, to determine its satisfaction with interest rate management products solely on whether the secured interest rate is lower than the level incorporated into the budget or financial forecast appears to be arbitrary. The Commission believes a more objective approach should be utilized to determine Kenergy's satisfaction with interest rate management products. An analysis should be performed to determine how beneficial the interest rate management product was to Kenergy. This analysis should weigh Kenergy's expectations at the time the treasury lock, or other management product, was established with the actual results and what would have happened without the management product. The Commission finds that Kenergy should utilize this type of analysis when considering additional treasury locks, additional interest rate management products, or raising the limit of funds covered by treasury locks or other interest rate management products.

IT IS THEREFORE ORDERED that:

1. Interest rate management products that are not under the supervision or control of a federal agency, and are used in conjunction with long-term debt, are required to be approved in advance by the Commission under KRS 278.300.

2. Kenergy's request to enter into a treasury lock with CoBank for up to \$5,500,000 on a loan advance from the pending \$31,622,000 RUS loan is approved.

3. Kenergy is authorized to enter into additional treasury locks with CoBank for future loan advances from the pending \$31,622,000 RUS loan if beneficial to Kenergy. However, Kenergy shall not be required to enter into a treasury lock on each subsequent loan advance.

4. Kenergy's request to approve the use of interest rate management products with all future loans provided by CoBank or other entities selected by Kenergy is denied.

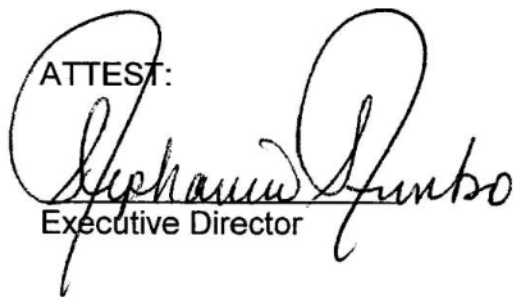
5. Kenergy shall perform the analysis described in the findings above when determining its satisfaction with a treasury lock or other interest rate management product.

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.

Done at Frankfort, Kentucky, this 10th day of June, 2008.

By the Commission

ATTEST:

Handwritten signature of Stephanie Gumbo in cursive script.

Executive Director

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