COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ELECTRONIC APPLICATION OF KENTUCKY UTILITIES COMPANY FOR AN ORDER AUTHORIZING THE ISSUANCE OF INDEBTEDNESS	))))	**CASE NO. 2020-00109**

RESPONSE OF
KENTUCKY UTILITIES COMPANY
TO ATTORNEY GENERAL'S FIRST SET OF
DATA REQUESTS
DATED APRIL 30, 2020

FILED: MAY 11, 2020

VERIFICATION

COMMONWEALTH OF KENTUCKY)
)
COUNTY OF JEFFERSON)

The undersigned, **Daniel K. Arbough**, being duly sworn, deposes and says that he is Treasurer for Louisville Gas and Electric Company and an employee of LG&E and KU Services Company, and that he has personal knowledge of the matters set forth in the responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

Daniel K. Arbough

Daniel K. Arbough

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 8th day of May 2020.

Judy Schooler (SEAL)

Notary Public

Notary Public, ID No. 603967

My Commission Expires:

7/11/2022

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Question No. 1

Witness: Daniel K. Arbough

Q-1. The Company's Application states, "[t]he First Mortgage Bonds and the Intermediate Term Financings are proposed in substitute of each other or in combination, so that the aggregate principal amount outstanding of the requested financing options at any one time will not exceed $750,000,000. KU will continue pursuing the most prudent and reasonable least cost financing option, or combination thereof, available at the time of the Company's decision under the current circumstances." See Application at numerical paragraph 13.

a. Describe the process for issuing First Mortgage Bonds with a focus on whether the circumstances that may play out on or before November 1, 2020 will make the issuance of First Mortgage Bonds a feasible option. In this description, please provide a schedule or timeline for known blackout dates and other factors implicating the likelihood of the ability to issue First Mortgage Bonds.

A-1. The process for issuing First Mortgage Bonds involves three phases: pre-transaction planning, marketing and pricing the bonds, and the bond closing phase.

During the pre-transaction phase, the Company selects a group of underwriting banks to assist with the bond issuance and works closely with the banks to evaluate the market conditions, including indicative pricing for various tenors. The transaction documents are also prepared during this part of the process. The underwriters conduct due diligence about the Company's financial condition to ensure all material events are disclosed to potential investors during this time as well. As part of the due diligence, the Company's auditors prepare an "agreed upon procedures letter" or "comfort letter" indicating they are comfortable with certain information contained in the Company's SEC reports and the bond offering prospectus. The underwriters may also ask the Company to conduct conference calls with investors to educate them about the Company during this period. The potential timing is also discussed during the planning phase. Typically, underwriters advise to avoid issuing bonds on days when market volatility could be elevated such as days when the Federal Reserve is conducting a press conference following a meeting of the Open Market Operations Committee when policy changes are announced. The Company is also prevented from issuing bonds when it is aware of material non-public information. Issuance cannot occur until that material information is made public. This is most common with the release of quarterly earnings by the Company. The quarterly books will be closed and provided to internal management within about one week of the end of the quarter. Once that information has been compiled, the Company is prevented from issuing bonds until that information becomes public via the release of a 10-Q or 10-K report. This period is commonly referred to as a blackout period. For KU, the 10-Q's are usually released within 35-40 days after quarter-end. As a result, KU is not able to issue bonds during most of the months of April, July, and October and potentially during the early part of May, August and November. The 10-K is usually issued in late February which effectively blacks out most of January and February. The other significant event of 2020 that underwriters recommend avoiding is the peak of the presidential campaign season. Election poll results can create significant volatility in markets. The $500 million bond matures on November 1 and can be called at par starting on August 1. Consequently, the Company prefers to complete the refinancing transaction no later than the end of August. The market for corporate debt has been very active, and interest rates are historically very low creating a very attractive environment for the Company to issue debt. However, a very unique issue has arisen as a consequence of the lockdown of the economy and government associated with the COVID-19 virus which has resulted in the closing of county clerk offices or changes to clerk office procedures to record liens. The Supplemental Indenture must be recorded in all counties where the Company has property to have a successful closing. The parties must be very confident in the ability to have the indenture recorded in a timely fashion before launching a transaction as a failed closing has very negative connotations in the market.

Once a decision has been made to proceed with a transaction, the Company and the underwriters will conduct a go/no-go call at the beginning of the day. If market conditions are favorable, the transaction will be launched with the issuance of the preliminary offering document which details the transaction structure, proposed maturity date, and incorporates the most recent SEC filings of the Company. It will not contain specific interest rates and may or may not include the bond amount. The underwriters use this document to market the bonds to potential investors. The underwriters and Company will agree on a credit spread to be discussed initially with investors which is known as Initial Price Talk. After a few hours, the Company and Underwriters will evaluate the level of orders that have been placed by investors to determine if the credit spread can be reduced and still retain sufficient orders. This process could be repeated again during the day, and a point will be reached when underwriters will indicate that the best credit spread available has been reached. At that point, the Company and the banks agree on the credit spread and lock in the interest rate of the bonds based on the Treasury bond with the same tenor as the First Mortgage Bonds plus the agreed credit spread. The bond terms are known, all of the information is inserted into the documents, and they are finalized.

The closing phase involves taking the Supplemental Indenture containing all of bond terms and recording it at each of the 69 County Clerk offices in Kentucky where KU has physical property. This perfects the lien of the mortgage. The investors are willing to have only a short period of time between the pricing of the bond and the closing – typically no more than five business days – to avoid having significant market swings between pricing and closing. In order for closing to occur, all 69 counties must have accepted the Supplemental

Indenture for recording and received the proper fee, and provided the Company with a receipt, stamp or other evidence of such actions. This allows the attorneys to provide a closing legal opinion that the lien has been perfected. If one county clerk is unable to provide the information, the transaction closing fails. The Company must be very certain the clerks will be able to provide the information in a timely fashion, including a process to promptly correct technical errors, before launching the transaction because a failed transaction is very rare in the market and the Company would be viewed very unfavorably by investors for future bond transactions if it has a failed transaction. Once the recording is completed, closing documents are exchanged and a final due diligence call occurs to ensure that no material events have occurred since pricing. At that point, the funds are released to the Company and the bonds are released to the trustee to hold on behalf of investors.

Everything is in place to issue First Mortgage Bonds once the Company announces first quarter results on May 8 other than the ability to record the lien in a timely fashion. The Company continues to monitor the availability of the clerks to perform this critical function. A full report of the most recent review is included in the response to PSC 1-1(c).

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Question No. 2

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Q-2. Provide a comparison of the interest rates that the Company would expect to pay related to the issuance of First Mortgage Bonds in comparison to the alternative financing options related to the replacement of the Series B Bonds. In this analysis, please compute the total value of the differences in these interest rates.

A-2. Pricing indications as of May 5, 2020 for a First Mortgage Bond, if issued are approximately 2.31% for a ten year bond and 3.18% for a 30 year bond. The interest rate for an unsecured bond would be higher than a First Mortgage Bond due to the expectation of it having a lower credit rating. It is unusual for a utility to have secured and unsecured bonds so pricing data is scarce. However, KU estimates that the unsecured bond interest rate would be 0.30% to 0.50% higher. It is important to note that the price differential does not matter if the Company is unable to issue First Mortgage Bonds due to the County Clerk offices being closed. The price differential can also be eroded by increases in credit spreads or Treasury bond rates if the Company is forced to wait to issue bonds until the County Clerk offices reopen. Bank term loans have a much shorter tenor and are priced as a spread above LIBOR. Indications for a two year term loan in the range of LIBOR + 1.625%.

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Question No. 3

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Q-3. To the extent the Company is required to enter into a financing option that does not include First Mortgage Bonds, describe whether the Company would seek to replace that financing with First Mortgage Bonds when practicable. Describe whether the terms of the alternative options would preclude or disadvantage replacement for some period.

A-3. The ability to replace one of the alternate forms of financing with a First Mortgage Bond when practicable depends on the type of financing used. If an unsecured bond is issued, it likely will include a make-whole provision that would require the Company to effectively make the investor no worse off than if the bond had been held to maturity. If interest rates have declined since the bond was issued and the investor must reinvest at a lower rate elsewhere, the Company must make a payment equal to the present value of the difference between the cash flow on the KU bond and the cash flow on a replacement investment. If a bank term loan is used, the loan can typically be repaid on any interest payment date without penalty. KU would likely look to replace a term loan with a First Mortgage Bond in the future once practicable, but the make-whole payment requirement would likely make it uneconomic to replace an unsecured bond.

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Q-4. Describe all communication of which the Company is aware which have occurred since the filing of the application and which impacts the ability of the Company to pursue First Mortgage Bond issuance, including but not limited to access to courthouses, etc.

A-4. See the response to PSC 1-1(c).

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Q-5. The Company issued the Series B Bonds which mature on November 1, 2020 pursuant to authority described in Case No. 2019-00242 and sought and granted in Case No. 2010-00206. Please clarify to which of the Company's expenses and obligations the funds received from the Series B Bond Issuance relate.

A-5. As per the application in Case No. 2010-00206, the Company refinanced its long-term taxable financings with Fidelia (totaling $1,331,000,000) following the acquisition by PPL. The Series B Bonds were part of that refinancing transaction. However, KU does not assign specific financing to any particular project or use and does not project-finance capital projects.

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Q-6. Describe the ratio of Company's debts in relation to its assets.

A-6. At March 31, 2020, the Company's debt to asset ratio was 34% as calculated below:

At March 31, 2020	KU
Notes Payable to Associated Company	$ -
Notes Payable	144,180,976
Other Long-Term Debt	2,639,822,967
Total Debt	**$ 2,784,003,943**
Total Assets	**$ 8,270,457,330**
Debt to Assets Ratio	**34%**