an e·on company

RECEIVED
APR 28 2009
PUBLIC SERVICE
COMMISSION

Mr. Jeff DeRouen, Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
P.O. Box 615
Frankfort, KY 40602-0615

Kentucky Utilities Company
State Regulation and Rates
220 West Main Street
PO Box 32010
Louisville, Kentucky 40232
www.eon-us.com

Lonnie E. Bellar
Vice President
T 502-627-4830
F 502-217-2109
lonnie.bellar@eon-us.com

April 24, 2009

Re: Financing for Pollution Control Equipment

Dear Mr. DeRouen:

Kentucky Utilities Company ("KU") recently applied for an additional tax-exempt bond allocation from the Kentucky Private Activity Bond Allocation Committee ("KPABAC") for funding qualified costs of solid waste abatement facilities associated with the construction of pollution control equipment at the E. W. Brown Generating Station. On March 27, the KPABAC informed KU that it had been awarded an allocation of $90,799,753. In accordance with 200 KAR 15:010, KU's allocation will expire on June 24, 2009, and the bonds must have been placed in the market by that date.

KU has been taking steps toward the issuance of the bonds authorized by the KPABAC, including preparing to file an application with the Commission pursuant to KRS 278.300. However, the current financial market turmoil has resulted in a situation where long-term tax-exempt bonds would be more expensive than if KU borrowed funds on a taxable basis. Recent market data from investment banks indicate that a 30 year fixed rate taxable loan from Fidelia using the "best rate method" approved by the Commission[1] would have an interest rate of 6.72%. Indications for a comparable 30 year tax-exempt bond show that its rate would be 6.95%. Including the issuance costs of the tax-exempt bonds, the present value of the cost differential between the two financing alternatives is approximately $2.7 million over the 30 year life of the financing.

[1] *See* Case No. 2008-00426, Order, November 5, 2009; Case No. 2007-00548, Order, February 13, 2008; Case No. 2007-00437, Order, November 1, 2007; Case No. 2007-00024, Order, March 19, 2007; Case No. 2006-00155, Order, May 22, 2006; Case No. 2005-00117, Order, May 10, 2005; Case No. 2003-00301, Order, September 22, 2003; and Case No. 2003-00059, Orders, April 14, 2003 and April 30, 2003.

KU has also utilized variable rate tax-exempt bond structures in the past, but such a structure would not be available in the current situation. To be viable in the current market, the variable rate structures would require letters of credit enhancing KU's credit. Banks continue to be very reluctant to extend such facilities to utilities such as KU. Indeed, difficulty in arranging for such facilities is one reason that KU has not yet been able to complete all the conversions and/or refinancing transactions contemplated in Case No. 2008-00132 (*The Application of Kentucky Utilities Company for an Order Authorizing the Issuance of Securities and the Assumption of Obligations).* Even after such a structure has been put in place, the rating agencies require nearly one month to provide a rating. Given market conditions and the deadline for issuance in June, arranging such a structure is not possible.

After evaluating the situation, KU has elected to forego the current allocation of tax-exempt funding. Historically, the tax-exempt market has provided significant cost benefits to KU and, consequently, its customers. KU expects that tax-exempt bonds will again be a source of reasonable capital and able to provide benefits in the future when market conditions have returned to more traditional levels. KU will take steps to obtain future allocations.

Please contact me if you or your staff have any questions or would like to discuss the situation.

Sincerely,

Lonnie

Lonnie E. Bellar