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Dianne B Kuhnell
Senior Paralegal

VIA OVERNIGHT DELIVERY

RECEIVED

January 20, 2009

JAN 21 2009

PUBLIC SERVICE
COMMISSION

Mr. Jeff Derouen
Executive Director
Kentucky Public Service Commission
211 Sower Blvd
Frankfort, KY 40601

Re: Case No. 2008-00503

Dear Mr. Derouen:

Enclosed please find an original and seven copies of the Responses to Initial Requests of Commission Staff to Duke Energy Kentucky in the above captioned case.

Please date-stamp the extra two copies of the filing and return to me in the enclosed envelope.

Sincerely,

Dianne B. Kuhnell
Senior Paralegal

RECEIVED

JAN 21 2009

PUBLIC SERVICE
COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of: APPLICATION OF)
DUKE ENERGY KENTUCKY, INC.)
FOR AN ORDER AUTHORIZING)
THE ISSUANCE OF UNSECURED) CASE NO. 2008-00503
DEBT AND LONG-TERM NOTES,)
EXECUTION AND DELIVERY OF)
LONG-TERM LOAN AGREEMENTS,)
AND USE OF INTEREST RATE)
MANAGEMENT INSTRUMENTS)

DUKE ENERGY KENTUCKY, INC.'S RESPONSES TO
INITIAL DATA REQUEST OF
COMMISSION STAFF
DATED JANUARY 8, 2009

VERIFICATION

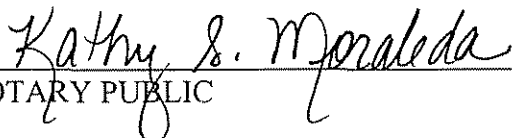
State of North Carolina)
) SS:
County of Mecklenburg)

The undersigned, Stephen G. De May, being duly sworn, deposes and says that I am employed by the Duke Energy Corporation affiliated companies as Vice President and Treasurer of Duke Energy Corporation; that on behalf of Duke Energy Kentucky, Inc., I have supervised the preparation of the responses to the foregoing responses to information requests; and that the matters set forth in the foregoing response to information requests are true and accurate to the best of my knowledge, information and belief after reasonable inquire.



Stephen G. De May, Affiant

Subscribed and sworn to before me by Stephen G. De May on this 14th day of January, 2009.



NOTARY PUBLIC

My Commission Expires: December 13, 2013

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Duke Energy Kentucky, Inc.
Case No. 2008-00503
First Set Staff Data Requests
Date Received: January 12, 2009

STAFF-DR-01-001

REQUEST:

Clarify whether Duke Kentucky is requesting Commission approval to issue up to a total of \$100 million or \$176.72 million in debt.

RESPONSE:

In the Application, Duke Kentucky requested approval to issue up to \$100 million of long term debt and \$76.72 million to refinance existing tax-exempt bonds for a total of \$176.72 million. The authorization may now be reduced from \$76.72 million to \$26.72 million since \$50 million of the tax-exempt bonds were refinanced in 2008. See response to Question 2 below.

PERSON RESPONSIBLE: Stephen G. DeMay

Duke Energy Kentucky, Inc.
Case No. 2008-00503
First Set Staff Data Requests
Date Received: January 12, 2009

STAFF-DR-01-002

REQUEST:

Refer to the top of page 2 of the application. Duke Kentucky is requesting authorization to borrow from Boone County, Kentucky, or another authorized issuer of tax exempt bonds, for a term not to exceed 40 years, up to a maximum of \$76.72 million. Duke Kentucky states that the proceeds will be used to refinance existing tax-exempt Authority Bonds. Duke Kentucky was given this same authorization in Case No. 2008-00118, through the period ending December 31, 2008.

a) Explain why the transaction did not occur prior to December 31, 2008, as anticipated in the previous case.

b) State whether the authorization requested in this case is identical to what the Commission authorized in Case No. 2008-00118, except for extending the time to complete the transactions through December 31, 2010. If no, identify all differences.

RESPONSE:

a. \$50 million of the tax exempt bonds were refinanced in December 2008 after Duke Energy Kentucky had submitted its Financing Authority Application. The remaining \$26.72 of the tax exempt bonds are planned to be refunded in 2009, subject to market conditions. Due to market conditions, Duke Energy Kentucky did not complete the entire refinancing in 2008 as initially anticipated.

b. The authorization requested in this case is identical to what the Commission authorized in Case No. 2008-00118 except for extending the time to complete the transactions through December 31, 2010. The authorization may now be reduced from \$76.72 million to \$26.72 million since \$50 million of the tax-exempt bonds were refinanced in 2008.

PERSON RESPONSIBLE: Stephen G. DeMay

Duke Energy Kentucky, Inc.
Case No. 2008-00503
First Set Staff Data Requests
Date Received: January 12, 2009

STAFF-DR-01-003

REQUEST:

Refer to page 3 of the application at paragraph 5 Duke Kentucky is requesting authorization to issue secured or unsecured debt, or a combination thereof.

- a) Identify the costs and benefits of issuing secured versus unsecured debt and provide the criteria Duke Kentucky will use to determine which type of debt to issue.
- b) Within the scope of this Duke Kentucky financing request, provide an estimate of the cost difference between issuing secured and unsecured debt.
- c) Explain whether Duke Kentucky will be required to make filings with the Securities and Exchange Commission ("SEC") if it issues secured debt and, if so, state the additional costs to be incurred and whether there would be any SEC-related accounting or reporting requirements.

RESPONSE:

- a. Depending on market conditions, secured debt is generally issued at a more favorable interest rate than unsecured debt due to the security of the credit enhancement. Duke Energy Kentucky does not currently have an active First Mortgage Bond Indenture, therefore any secured debt issuance will require the creation of a mortgage indenture. In addition, secured debt tends to give rise to greater administrative and compliance requirements. At time of issue, Duke Energy Kentucky will consider the costs and benefits associated with secured versus unsecured debt and select the overall most cost effective method of raising debt financing.
- b. Under current market conditions, the interest rate cost difference between issuing secured debt versus unsecured debt is estimated to be approximately 50 basis points. On a historical basis, this interest rate differential has been as low as 10 to 15 basis points. Given that Duke Kentucky does not currently have any

secured debt outstanding, this interest rate differential may be reduced by enhancing the unsecured debt covenants. In addition, issuing unsecured debt avoids the costs associated with the creation of a mortgage indenture and the added administrative costs associated with managing mortgage indenture compliance.

c. Duke Kentucky is not an SEC registrant and therefore does not have any SEC related reporting requirements.

PERSON RESPONSIBLE: Stephen G. DeMay

Duke Energy Kentucky, Inc.
Case No. 2008-00503
First Set Staff Data Requests
Date Received: January 12, 2009

STAFF-DR-01-004

REQUEST:

Refer to pages 12 and 13 of the application, paragraph 9, which states that, in Case No. 2006-00563, the Commission authorized the issuance of up to \$100 million of securities for a period ending December 31, 2008. State whether the authorization requested in this case is identical to what the Commission authorized in Case No. 2006-00563, except for extending the time to complete the transactions through December 31, 2010. If no, identify all other differences.

RESPONSE:

The authorization requested in this case is identical to what the Commission authorized in Case No. 2006-00563, except for extending the time to complete the transactions through December 31, 2010.

PERSON RESPONSIBLE: Stephen G. DeMay

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Duke Energy Kentucky, Inc.
Case No. 2008-00503
First Set Staff Data Requests
Date Received: January 12, 2009

STAFF-DR-01-005

REQUEST:

Refer to Exhibit E, page 3, of the application. The middle of the page shows that, for the Series 2006B bonds, the variable rate debt was swapped to a fixed rate of 3.86 percent for the life of the debt. Given that it carries what appears to be a favorable interest rate, explain why Duke Kentucky is proposing to refinance this debt.

RESPONSE:

Duke Kentucky pays a floating rate on the bonds and receives 70% of one month LIBOR under the fixed rate swap. The total interest cost to Duke Kentucky on the bonds is the difference between the floating rate paid on the bonds plus the fixed rate of 3.86% less the 70% of LIBOR received under the fixed rate swap.

The auction rate tax-exempt market is not functioning properly. There is very little liquidity in this market for investors, which has resulted in repeated failed auctions. Duke Kentucky's failed auction rate is set at two times one month LIBOR, and during the market volatility in 2008, the failed auction rate set as high as 8.56%. At that time, the total interest paid on these bonds was a failed auction rate of 8.56% plus the fixed rate of 3.86% under the swap less the floating rate of 3.00% [70% of 4.28%] received under the swap for a total interest payment of 9.42%.

Currently, the one month LIBOR rate is approximately .36%. On this basis, the current all-in interest cost of these bonds is 4.33% [2 X .36% plus 3.86% less (.7 X .36%)]

The failed auction rate of interest no longer matches well with the floating rate received under the fixed rate swap, and at times the difference has been extremely wide. Duke Kentucky is requesting approval to allow for the refinancing of these bonds into a form that is more acceptable to the market. The tax-exempt market remains volatile, therefore the timing of this refunding is dependent on more favorable market conditions. Upon refinancing these bonds, the fixed rate swap may or may not remain in place.

PERSON RESPONSIBLE: Stephen G. DeMay