

the June Order,<sup>2</sup> except that Applicants request that LG&E and KU may grant security for the intercompany loans.<sup>3</sup> LG&E and KU request authorization to secure intercompany loans with a subordinated lien on certain of the personal property of each company, including "utility assets" within the meaning of the Act. The subordination provisions will provide that the E.ON group companies cannot exercise any rights or remedies against the property of LG&E and KU unless all bonds under the borrowing company's first mortgage bond indenture have been paid in full. The aggregate outstanding principal amount of intercompany loans made to LG&E and KU on a secured basis will not exceed \$275 million and \$215 million, respectively. LG&E and KU commit that the aggregate principal amount of secured intercompany loans, together with the aggregate principal amount of bonds issued under their respective first mortgage bond indenture, will not exceed the limit on bonds set forth in their first mortgage bond indenture.<sup>4</sup> The Applicants further commit that neither LG&E nor KU will borrow any funds as secured intercompany loans under the authority granted, unless at the time of the incurrence of any secured intercompany loan, the following conditions are met:

A. E.ON and the borrowing company (LG&E or KU, as the case may be) maintain common equity<sup>5</sup> as a percentage of total capitalization<sup>6</sup> of at least 30%, as reflected

<sup>2</sup> The financing authority granted in the June Order requires that all borrowings by LG&E Energy and its subsidiary companies (the "LG&E Energy Group") from an associate company be at the lowest of: (i) E.ON's effective cost of capital; (ii) the lending associate's effective cost of capital (if lower than E.ON's effective cost of capital); and (iii) the borrowing LG&E Energy Group company's effective cost of capital determined by reference to the effective cost of a direct borrowing by the company from a nonassociate for a comparable term loan that could be entered into at that time (the "Best Rate Method"). E.ON states that the Best Rate Method assures that an LG&E Energy Group company that elects to obtain debt financing from an associate company would not pay more for that financing than it would pay in the capital markets for a similar loan had the borrower sought to finance its capital requirements with independent third parties.

<sup>3</sup> LG&E and KU are currently participants in a utility money pool, through which each company may borrow funds on an unsecured basis. The operation of the utility money pool would not be affected by this proposal, and money pool transactions would remain unsecured.

<sup>4</sup> Currently, LG&E and KU have sufficient capacity under their respective first mortgage bond indenture to issue first mortgage bonds, or alternatively to incur secured intercompany loans, in the amount of the authorization requested.

<sup>5</sup> Common stock equity includes common stock (i.e., amounts received equal to par or stated value of the common stock), additional paid in capital, retained earnings and minority interests.

<sup>6</sup> Common stock to total capitalization ratio is calculated as follows: common stock equity/

in their most recent annual or semiannual report. Applicants request that the Commission reserve jurisdiction over the making of secured intercompany loans at any time that this condition is not satisfied.

B. All outstanding securities of the borrowing company that are rated are rated investment grade, and all outstanding securities of E.ON that are rated are rated investment grade. For purposes of this provision, a security will be deemed to be rated investment grade if it is rated investment grade by at least one nationally recognized statistical rating organization, as defined in rule 15c3-1(c)(2)(vi)(F) under the Securities Exchange Act of 1934. Applicants request that the Commission reserve jurisdiction over the making of secured intercompany loans at any time that this condition is not satisfied.

The secured intercompany loans would be in compliance with the Best Rate Method. Therefore, LG&E and KU would not pay more than they would pay in the capital markets for a similar loan had the borrower sought to finance its capital requirements with independent third parties. LG&E and KU would save the issuance expenses associated with the issuance of first mortgage bonds. These expenses would typically include legal fees, printing costs, trustees fees, rating agency fees and filing fees. In recent transactions, these expenses have aggregated approximately \$300,000 per issuance.

E.ON states that its financing policy is to centralize, wherever possible, all external funding at the E.ON level. This strategy, it says, allows E.ON to ensure that all funds are raised at the lowest cost due to the greater financial strength of the holding company. Applicants state that E.ON (currently AA-, stable outlook, from Standard & Poor's, and A1, stable outlook, from Moody's) is the strongest credit in the E.ON Group. Lenders and bond investors see E.ON (and its finance companies under its guarantee) as the most creditworthy company in the E.ON Group, according to the Applicants; and E.ON receives the best margins and other terms and conditions. Therefore, according to the Applicants, E.ON (or its finance companies under guarantee of E.ON) is the preferred entity of the E.ON Group to approach the capital markets. E.ON lends the proceeds from financings in the form of intercompany loans to those subsidiaries with demand. According to the Applicants, for subsidiary companies to raise funds externally would create inefficiencies in E.ON's strategy because E.ON's creditors would be structurally subordinated to the debt of the subsidiaries. This would result in

(common stock equity + preferred stock + gross debt). Gross debt is the sum of long-term debt, short-term debt and current maturities.

increased costs for E.ON, and consequently, all of its subsidiaries.

The articles of incorporation of LG&E and KU contain provisions for the benefit of the holders of their preferred shares that limits the amount of unsecured indebtedness which may be outstanding at any time that the company has any preferred shares outstanding. The unsecured debt limit at LG&E is 20% of the sum of (a) secured debt plus (b) total of capital and surplus. The limit at KU is 25% of the same sum. In order to exceed these limits, LG&E and KU would need to obtain the consent of the holders of a majority of the preferred shares outstanding.

Applicants state that LG&E and KU have significant projected capital and financing needs, including those related to the pending maturity of first mortgage bonds, the anticipated need to finance the installation of pollution control equipment and the planned acquisition of additional electric generation capacity in 2003. The projected capital expenditure budgets for LG&E and KU for 2003 and 2004 are approximately \$340 million and \$550 million, respectively. The limit on unsecured indebtedness in the Articles of Incorporation of LG&E and KU constrains the financing options available to LG&E and KU to finance these needs, Applicants state. The secured intercompany loans, as long-term debt, will provide a cost-efficient means for LG&E and KU to finance their capital needs, including payment of maturing indebtedness and financing of capital expenditures, according to the Applicants. The secured intercompany loans may also be used to finance the payments due upon termination of the accounts receivable securitization programs of LG&E and KU. The accounts receivable securitization programs, which were scheduled to terminate at the end of July 2003, are in the process of being extended.

The intercompany loans to be made by Fidelia to LG&E and KU will be made according to separate loan and security agreements between Fidelia and the borrower. The agreement documents the intercompany loan, specifying the Best Rate Method for determining the interest rate to be applicable to the loans and providing for the grant of a security interest in the specified collateral. The interest rate on the notes will be set at the time of issuance, based upon the maturity of the notes. At the time of the proposed intercompany loan, the borrowing company will obtain quotes from investment banks for a first mortgage bond issued by that company and quotes for an unsecured bond issued by E.ON. The interest rate