



a PPL company

Jeff DeRouen, Executive Director  
Public Service Commission of Kentucky  
211 Sower Boulevard  
P. O. Box 615  
Frankfort, Kentucky 40602

RECEIVED

OCT 25 2011

PUBLIC SERVICE  
COMMISSION

**Kentucky Utilities Company**  
State Regulation and Rates  
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October 25, 2011

**RE: *The Application of Kentucky Utilities Company for Certificates of Public Convenience and Necessity and Approval of Its 2011 Compliance Plan for Recovery by Environmental Surcharge***  
**Case No. 2011-00161**

Dear Mr. DeRouen:

Pursuant to the Commission's Orders dated October 18, 2011 in the above referenced matter, with this letter Kentucky Utilities Company (KU) is filing one (1) original in paper format of the attachments to KU's responses previously provided in electronic format on September 1, 2011 to the following:

- Commission Staff's Supplemental Information Request dated August 18, 2011, Question No. 2(d), provided pursuant to a Petition for Confidential Protection filed on September 1, 2011;
- Attorney General's Supplemental Data Response dated August 18, 2011, Question Nos. 5 and 8.

On September 1, 2011, pursuant to a Motion to Deviate, KU filed one (1) original in paper format of the attachments to the following responses:

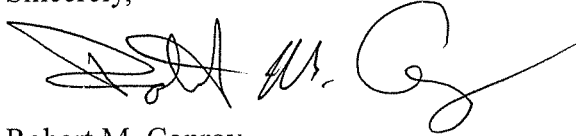
- Commission Staff's Supplemental Information Request dated August 18, 2011, Question No. 14(c);
- Attorney General's Supplemental Data Response dated August 18, 2011, Question Nos. 2, 4, and 6;
- KIUC's Second Set of Data Response dated August 18, 2011, Question Nos. 2-5 and 2-16 provided pursuant to a Petition for Confidential Protection filed on September 1, 2011;

Mr. Jeff DeRouen  
October 25, 2011

- Sierra Club et al. Supplemental Requests for Information dated August 18, 2011, Question No. 30.

Should you have any questions regarding the enclosed, please contact me at your convenience.

Sincerely,

A handwritten signature in black ink, appearing to read "R. M. Conroy". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Robert M. Conroy

cc: Parties of Record (w/o attachments)

In the Matter of:

THE APPLICATION OF KENTUCKY UTILITIES )  
COMPANY FOR CERTIFICATES OF PUBLIC )  
CONVENIENCE AND NECESSITY AND ) CASE NO.  
APPROVAL OF ITS 2011 COMPLIANCE PLAN ) 2011-00161  
FOR RECOVERY BY ENVIRONMENTAL )  
SURCHARGE )

**Response to the Attorney General's Supplemental Data  
Requests Question No. 8 dated August 18, 2011  
One Paper Copy - Volume 1 of 4  
Filed - October 25, 2011**

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF KENTUCKY UTILITIES )  
COMPANY FOR CERTIFICATES OF PUBLIC )  
CONVENIENCE AND NECESSITY AND )  
APPROVAL OF ITS 2011 COMPLIANCE PLAN ) CASE NO. 2011-00161  
FOR RECOVERY BY ENVIRONMENTAL )  
SURCHARGE )

RECEIVED

OCT 25 2011

PUBLIC SERVICE  
COMMISSION

KENTUCKY UTILITIES COMPANY  
RESPONSE TO THE  
ATTORNEY GENERAL'S SUPPLEMENTAL DATA REQUESTS  
DATED AUGUST 18, 2011

**ONE PAPER COPY  
QUESTION NO. 8**

FILED: OCTOBER 25, 2011

**KENTUCKY UTILITIES COMPANY**

**Response to Attorney General's Supplemental Data Requests Dated August 18, 2011**

**Case No. 2011-00161**

**Question No. 8**

**Witness: Shannon L. Charnas**

- Q-8. Please provide copies of the financial statements (balance sheet, income statement, statement of cash flows, and the notes to the financial statements) for PPL and the Company for the past two years. Please provide copies of the financial statements in both hard copy and electronic (Microsoft Excel) formats, with all data and formulas intact. If this information has been provided in response to another data request, please indicate the appropriate data request number, the document title, and the page number(s).
- A-8. Please refer to the attachments on CD in the folder titled Question No. 8. The financial statements are presented in .pdf format, which is the format in which they are filed. There are no Excel versions of the published financial statements.

**Kentucky Utilities Company**

**Financial Statements and Additional Information**

*As of December 31, 2009 and 2008 and For the Years Ended  
December 31, 2009, 2008 and 2007*

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## INDEX OF ABBREVIATIONS

AG	Attorney General of Kentucky
ARO	Asset Retirement Obligation
ASC	Accounting Standards Codification
CAIR	Clean Air Interstate Rule
CCN	Certificate of Public Convenience and Necessity
Clean Air Act	The Clean Air Act, as amended in 1990
CMRG	Carbon Management Research Group
Company	KU
CT	Combustion Turbines
DSM	Demand Side Management
ECR	Environmental Cost Recovery
EEl	Electric Energy, Inc.
E.ON	E.ON AG
E.ON U.S.	E.ON U.S. LLC
E.ON U.S. Services	E.ON U.S. Services Inc.
EPA	U.S. Environmental Protection Agency
EPAct 2005	Energy Policy Act of 2005
FAC	Fuel Adjustment Clause
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
FGD	Flue Gas Desulfurization
Fidelia	Fidelia Corporation (an E.ON affiliate)
GHG	Greenhouse Gas
Gwh	Gigawatt hours or one thousand Mwh
IBEW	International Brotherhood of Electrical Workers
IMEA	Illinois Municipal Electric Agency
IMPA	Indiana Municipal Power Agency
IRS	Internal Revenue Service
KCCS	Kentucky Consortium for Carbon Storage
Kentucky Commission	Kentucky Public Service Commission
KIUC	Kentucky Industrial Utility Consumers, Inc.
KU	Kentucky Utilities Company
Kwh	Kilowatt hours
LG&E	Louisville Gas and Electric Company
LG&E Energy	LG&E Energy LLC (now E.ON U.S. LLC)
MISO	Midwest Independent Transmission System Operator, Inc.
MMBtu	Million British thermal units
Moody's	Moody's Investor Services, Inc.
MVA	Megavolt-ampere
Mw	Megawatts
Mwh	Megawatt hours
NERC	North American Electric Reliability Corporation
NOV	Notice of Violation
NOx	Nitrogen Oxide
OMU	Owensboro Municipal Utilities
OVEC	Ohio Valley Electric Corporation
PUHCA 2005	Public Utility Holding Company Act of 2005
RSG	Revenue Sufficiency Guarantee
S&P	Standard & Poor's Rating Services
SCR	Selective Catalytic Reduction
SIP	State Implementation Plan
SO <sub>2</sub>	Sulfur Dioxide
TC1	Trimble County Unit 1
TC2	Trimble County Unit 2
VDT	Value Delivery Team Process
Virginia Commission	Virginia State Corporation Commission



## Business

### GENERAL

KU, incorporated in Kentucky in 1912 and in Virginia in 1991, is a regulated public utility engaged in the generation, transmission, distribution and sale of electric energy in Kentucky, Virginia and Tennessee. KU provides electric service to approximately 515,000 customers in 77 counties in central, southeastern and western Kentucky, to approximately 30,000 customers in 5 counties in southwestern Virginia and 5 customers in Tennessee. KU's service area covers approximately 6,600 square miles. Approximately 99% of the electricity generated by KU is produced by its coal-fired electric generating stations. The remainder is generated by a hydroelectric power plant and natural gas and oil fueled CTs. In Virginia, KU operates under the name Old Dominion Power Company. KU also sells wholesale electric energy to 12 municipalities.

KU is a wholly-owned subsidiary of E.ON U.S., an indirect wholly-owned subsidiary of E.ON, a German corporation. KU's affiliate, LG&E, is a regulated public utility engaged in the generation, transmission, distribution and sale of electric energy and the distribution and sale of natural gas in Kentucky.

### OPERATIONS

The sources of operating revenues and volumes of sales for the years ended December 31, 2009, 2008 and 2007 were as follows:

	2009		2008		2007	
	Revenues (millions)	Volumes (Gwh)	Revenues (millions)	Volumes (Gwh)	Revenues (millions)	Volumes (Gwh)
Residential	\$ 480	6,594	\$ 462	6,803	\$ 430	6,847
Industrial & Commercial	637	10,171	636	10,709	597	11,047
Municipals	91	1,848	92	1,971	90	2,058
Other Retail	118	1,647	108	1,707	98	1,691
Wholesale	29	660	107	2,894	57	1,582
Total	<u>\$ 1,355</u>	<u>20,920</u>	<u>\$ 1,405</u>	<u>24,084</u>	<u>\$ 1,272</u>	<u>23,225</u>

KU's peak load in 2009 was 4,640 Mw on January 16, 2009, when the temperature reached a low of -3 degrees Fahrenheit in Lexington.

The Company's power generating system includes coal-fired units operated at its four steam generating stations. Natural gas and oil fueled CTs supplement the system during peak or emergency periods. As of December 31, 2009, KU owned and operated the following generating stations while targeting a 13%-15% reserve margin:

	Summer Capability Rating (Mw)
Steam Stations:	
Ghent – Carroll County, KY	1,918
E.W. Brown – Mercer County, KY	697
Green River – Muhlenberg County, KY	163
Tyrone – Woodford County, KY	71
Total Steam Stations	<u>2,849</u>
Dix Dam Hydroelectric Station – Mercer County, KY	24
CT Generators (Peaking capability):	
E.W. Brown – Mercer County, KY*	757
Trimble County – Trimble County, KY *	632
Paddy's Run – Jefferson County, KY *	74
Haefling – Fayette County, KY	36
Total CT Generators	<u>1,499</u>
Total Capability Rating	<u>4,372</u>

\* Some of these units are jointly owned with LG&E. See Note 10 of Notes to Financial Statements for information regarding jointly owned units.

At December 31, 2009, KU's transmission system included 130 substations (52 of which are shared with the distribution system) with transformer capacity of approximately 13,016 MVA and approximately 4,040 miles of lines. The distribution system included 479 substations (52 of which are shared with the transmission system) with transformer capacity of approximately 6,973 MVA, 14,136 miles of overhead lines and 2,209 miles of underground conduit.

KU has a power purchase agreement with OMU which will be terminated by OMU in May 2010, owns 20% of EEI's common stock and owns 2.5% of OVEC's common stock. Additional information regarding these relationships is provided in Notes 1 and 9 of Notes to Financial Statements.

KU has contracts with the Tennessee Valley Authority to act as its transmission Reliability Coordinator and Southwest Power Pool, Inc. ("SPP") to function as its independent transmission operator, pursuant to FERC requirements. SPP has given notice of its intent to terminate the contractual arrangement with KU as of September 2010. KU has submitted filings with the FERC proposing revised independent transmission operator arrangements in connection with the potential expiration of its contract with SPP. See Note 2 of Notes to Financial Statements.

## RATES AND REGULATIONS

E.ON, KU's ultimate parent, is a registered holding company under PUHCA 2005. E.ON, its utility subsidiaries, including KU, and certain of its non-utility subsidiaries are subject to extensive regulation by the FERC with respect to numerous matters, including: electric utility facilities and operations, wholesale sales of power and related transactions, accounting practices, issuances and sales of securities, acquisitions and sales of utility properties, payments of dividends out of capital and surplus, financial matters and inter-system sales of non-power goods and services. KU believes that it has adequate authority (including financing authority) under existing FERC orders and regulations to conduct its business and will seek additional authorization when necessary.

The Company is subject to the jurisdiction of the Kentucky Commission, the Virginia Commission, the Tennessee Regulatory Authority and the FERC in virtually all matters related to electric utility regulation, and as such, its accounting is subject to the regulated operations guidance of the FASB ASC. Given its competitive position in the marketplace and the status of regulation in Kentucky and Virginia, there are no plans or intentions to discontinue the application of the regulated operations guidance of the FASB ASC.

In January 2010, KU filed an application with the Kentucky Commission requesting increases in its base electric rates of approximately 12%, or \$135 million annually, including an 11.5% return on equity. KU has requested the increases, based on the twelve month test year ended October 31, 2009, to become effective on and after March 1, 2010. The requested rates have been suspended until August 1, 2010, at which time they may be put into effect, subject to refund, if the Kentucky Commission has not issued an order in the proceeding. See Notes 2 and 12 of Notes to Financial Statements.

In June 2009, KU filed an application with the Virginia Commission requesting an increase in electric base rates for its Virginia jurisdictional customers of \$12 million annually or approximately 21%. The proposed increase reflected a proposed rate of return on rate base of 8.586% based upon a return on equity of 12%. During December 2009, KU and the Virginia Commission Staff agreed to a Stipulation and Recommendation authorizing a base rate revenues increase of \$11 million annually and a return on rate base of 7.846% based on a 10.5% return on common equity. In March 2010, the Virginia Commission approved the stipulation, with rates to become effective in April 2010. See Notes 2 and 12 of Notes to Financial Statements.

In January 2009, a significant ice storm passed through KU's service territory causing approximately 199,000 customer outages, followed closely by a severe wind storm in February 2009, causing approximately 44,000 customer outages. The Company filed an application with the Kentucky Commission in April 2009, requesting approval to establish a regulatory asset, and defer for future recovery, approximately \$62 million in incremental operation and maintenance expenses related to the storm restoration. In September 2009, the Kentucky Commission issued an Order allowing the Company to establish a regulatory asset of up to \$62 million based on its actual costs for storm damages and service restoration due to the January and February 2009 storms. In September 2009, the Company established a regulatory asset of \$57 million for actual costs incurred. As part of the rate case filed in January 2010, the Company is seeking recovery of these costs over a five year period.

In September 2008, high winds from the remnants of Hurricane Ike passed through the service territory causing significant outages and system damage. In October 2008, KU filed an application with the Kentucky Commission requesting approval to establish a regulatory asset, and defer for future recovery, approximately \$3 million of expenses related to the storm restoration. In December 2008, the Kentucky Commission issued an Order allowing the Company to establish a regulatory asset of up to \$3 million

based on its actual costs for storm damages and service restoration due to Hurricane Ike. In December 2008, the Company established a regulatory asset of \$2 million for actual costs incurred. As part of the rate case filed in January 2010, the Company is seeking recovery of these costs over a five year period.

In July 2008, KU filed an application with the Kentucky Commission requesting an increase in base electric rates. In conjunction with the filing of the application for a change in base rates, based on previous Orders by the Kentucky Commission approving settlement agreements among all interested parties, the VDT surcredit terminated in August 2008. In February 2009, the Kentucky Commission issued an order approving a settlement agreement among KU, the AG, the KIUC and all other parties to the rate case, under which KU's base electric rates decreased by \$9 million annually effective February 6, 2009, at which time the merger surcredit terminated. See Note 2 of Notes to Financial Statements.

In February 2007, KU completed a series of financial transactions that allowed it to cease periodic reporting under the Securities Exchange Act of 1934. See Note 7 of Notes to Financial Statements.

For a further discussion of regulatory matters, see Notes 2 and 9 of Notes to Financial Statements.

## COAL SUPPLY

Coal-fired generating units provided approximately 99% of KU's net Kwh generation for 2009. The remaining net generation for 2009 was provided by natural gas and oil fueled CT peaking units and a hydroelectric plant. Coal is expected to be the predominant fuel used by KU in the foreseeable future, with natural gas and oil being used for peaking capacity and flame stabilization in coal-fired boilers or in emergencies. The Company has no nuclear generating units and has no plans to build any in the foreseeable future.

Fuel inventory is maintained at levels estimated to be necessary to avoid operational disruptions at the coal-fired generating units. Reliability of coal deliveries can be affected from time to time by a number of factors including fluctuations in demand, coal mine production issues and other supplier or transporter operating difficulties.

KU has entered into coal supply agreements with various suppliers for coal deliveries for 2010 and beyond and normally augments its coal supply agreements with spot market purchases. The Company has a coal inventory policy which it believes provides adequate protection under most contingencies.

KU expects to continue purchasing most of its coal, which has sulfur content in the 0.7% - 3.5% range, from western and eastern Kentucky, West Virginia, southern Indiana, southern Illinois and Ohio for the foreseeable future. With the installation of FGDs (SO<sub>2</sub> removal systems), KU expects its use of higher sulfur coal to increase, the combination of which is expected to enable KU to continue to provide electric service in compliance with existing environmental laws and regulations. Coal is delivered to KU generating stations by a mix of transportation modes, including barge, truck and rail.

## ENVIRONMENTAL MATTERS

**General.** Protection of the environment is a major priority for KU and a significant element of its business activities. KU's properties and operations are subject to extensive environmental-related oversight by federal, state and local regulatory agencies, including via air quality, water quality, waste management and similar laws and regulations. Therefore, KU must conduct its operations in accordance with numerous permit and other requirements issued under or contained in such laws or regulations.

**Climate Change.** Recent developments continue to indicate an increased possibility of significant climate change or GHG legislation or regulation, at the international, federal, regional and state levels. During December 2009, as part of the United Nation's Copenhagen Accord, the United States agreed to a non-binding goal to reduce GHG emissions to 17% below 2005 levels by 2020. Additionally, during 2009, the U.S. House of Representatives passed a comprehensive GHG legislation, which included a number of measures to limit GHG emissions and achieve GHG emission reduction targets below 2005 levels of 3%, 17% and 83% by 2012, 2020 and 2050, respectively, and the U.S. Senate is considering companion legislation. In late 2009, the U.S. EPA issued or proposed various regulatory initiatives relating to GHG matters, including an endangerment finding relating to mobile sources of GHGs, a GHG reporting requirement and a proposed rule relating to permitting requirements for new or modified GHG emission sources. Finally, a number of U.S. states, although not currently including Kentucky, have adopted GHG-reduction legislation or regulation of various sorts. The developing GHG initiatives include a number of differing structures and formats, including direct limitations on GHG sources, issuance of allowances for GHG emissions, cap-and-trade programs for such allowances, renewable or alternative generation portfolio standards, and mechanisms relating to demand reduction, energy efficiency, smart-grid, transmission expansion, carbon-sequestration or other GHG-reducing efforts.

While the final terms and impacts of such initiatives cannot be estimated, KU, as a primarily coal-fired utility, could be highly affected by such proceedings. Among other emissions, GHGs include carbon-dioxide, which is produced via the combustion of fossil-fuels such as coal and natural gas. KU's generating fleet is approximately 63% coal-fired, 37% oil/gas-fired and less than 1% hydroelectric based on capacity. During 2009, KU produced approximately 99% of its electricity from coal and 1% from natural gas combustion, on a Mwh basis. During 2009, KU's emissions of GHGs were approximately 14.2 million metric tons of carbon-dioxide equivalents from KU's owned or controlled generation sources. While its generation activities account for the bulk of its GHG emissions, other GHG sources at KU include operation of motor vehicles and powered equipment, evaporation associated with gas pipelines, refrigerating equipment and similar activities.

Ultimately, environmental matters or potential environmental matters can represent an important element of current or future potential capital requirements, operating and maintenance expenses or compliance risks for the Company. While KU currently anticipates that many of such direct costs or effects may be recoverable through rates or other regulatory mechanisms, particularly with respect to coal-related generation, the availability, timing or completeness of such rate recovery cannot be assured. Ultimately, climate change matters could result in material effects on KU's results of operations, liquidity and financial position. See Risk Factors; Management's Discussion and Analysis and Note 9 of Notes to Financial Statements for additional information.

## STATE EXECUTIVE OR LEGISLATIVE MATTERS

In November 2008, the Commonwealth of Kentucky issued an action plan to create efficient, sustainable energy solutions and strategies and move toward state energy independence. The plan outlines the following seven strategies to work toward these goals:

- Improve the energy efficiency of Kentucky's homes, buildings, industries and transportation fleet
- Increase Kentucky's use of renewable energy
- Sustainably grow Kentucky's production of biofuels
- Develop a coal-to-liquids industry in Kentucky to replace petroleum-based liquids
- Implement a major and comprehensive effort to increase gas supplies, including coal-to-gas in Kentucky

- Initiate aggressive carbon capture/sequestration projects for coal-generated electricity in Kentucky
- Examine the use of nuclear power for electricity generation in Kentucky

In December 2009, the Governor of Kentucky's Executive Task Force on Biomass and Biofuels issued a final report to establish potential strategic actions to develop biomass and biofuels industries in Kentucky. The plan noted the potential importance of biomass as a renewable energy source available to Kentucky and discussed various goals or mechanisms, such as the use of approximately 25 million tons of biomass for generation fuel annually, allotment of electricity and gas taxes and state tax credits to support biomass development.

In January 2010, a state-established Kentucky Climate Action Plan Council commenced formal activities. The council, which includes governmental, industry, consumer and other representatives, seeks to identify possible Kentucky responses to potential climate change and federal legislation, including increasing statewide energy efficiency, energy independence and economic growth. The council has established various technical work groups, including in the areas of energy supply and energy efficiency/conservation, to provide input, data and recommendations.

During the current session of the Kentucky General Assembly, as during prior annual or bi-annual legislative sessions, the Kentucky General Assembly has introduced various bills with respect to environmental or utility matters, including potential renewable energy portfolio requirements, energy conservation measures, coal mining or coal byproduct operations and other matters. The current session is scheduled to end in April 2010, and until such time the prospects and final terms of any such legislation cannot be determined.

Legislative and regulatory actions as a result of these proposals and their impact on KU, which may be significant, cannot currently be predicted.

## COMPETITION

At this time, neither the Kentucky General Assembly nor the Kentucky Commission has adopted or approved a plan or timetable for retail electric industry competition in Kentucky. The nature or timing of the ultimate legislative or regulatory actions regarding industry restructuring and their impact on KU, which may be significant, cannot currently be predicted. Virginia, formerly a deregulated jurisdiction, has enacted legislation which implements a hybrid model of cost-based regulation. See Note 2 of Notes to Financial Statements for additional information.

## EMPLOYEES AND LABOR RELATIONS

KU had 964 full-time regular employees at December 31, 2009, 149 of which were operating, maintenance and construction employees represented by the IBEW Local 2100 and the United Steelworkers of America ("USWA") Local 9447-01. Effective August 4, 2009, the Company and its employees represented by the IBEW Local 2100 entered into a three-year collective bargaining agreement. The agreement provides for negotiated increases or changes to wages, benefits or other provisions and for annual wage re-openers. The Company and employees represented by the USWA Local 9447-01 entered into a three-year collective bargaining agreement in August 2008. This agreement provides for negotiated increases or changes to wages, benefits or other provisions and for annual wage re-openers.

## OFFICERS OF THE COMPANY

At December 31, 2009:

<u>Name</u>	<u>Age</u>	<u>Position</u>	<u>Effective Date of Election to Present Position</u>
Victor A. Staffieri	54	Chairman of the Board, President and Chief Executive Officer	May 2001
John R. McCall	66	Executive Vice President, General Counsel, Corporate Secretary and Chief Compliance Officer	July 1994
S. Bradford Rives	51	Chief Financial Officer	September 2003
Chris Hermann	62	Senior Vice President – Energy Delivery	February 2003
Paula H. Pottinger	52	Senior Vice President – Human Resources	January 2006
Paul W. Thompson	52	Senior Vice President – Energy Services	June 2000
Wendy C. Welsh*	55	Senior Vice President – Information Technology	December 2000
Michael S. Beer	51	Vice President – Federal Regulation and Policy	September 2004
Lonnie E. Bellar	45	Vice President – State Regulation and Rates	August 2007
Kent W. Blake	43	Vice President – Corporate Planning and Development	August 2007
D. Ralph Bowling	52	Vice President – Power Production	June 2008
Laura G. Douglas	60	Vice President – Corporate Responsibility and Community Affairs	November 2007
R. W. Chip Keeling	53	Vice President – Communications	March 2002
John P. Malloy	48	Vice President – Energy Delivery – Retail Business	April 2007
Dorothy E. O'Brien	56	Vice President and Deputy General Counsel – Legal and Environmental Affairs	October 2007
George R. Siemens	60	Vice President – External Affairs	January 2001
David S. Sinclair	48	Vice President – Energy Marketing	January 2008
P. Greg Thomas	53	Vice President – Energy Delivery – Distribution Operations	April 2007
John N. Voyles, Jr.	55	Vice President – Transmission & Generation Services	June 2008
Daniel K. Arbough	48	Treasurer	December 2000
Valerie L. Scott	53	Controller	January 2005

Officers generally serve in the same capacities at KU and its affiliates, E.ON U.S. and LG&E.

\*Ms. Welsh announced her retirement from the Company during November 2009, effective January 2010.

## Risk Factors

KU is subject to a number of risks, including without limitation, those listed below and elsewhere in this document. Such risks could affect actual results and cause results to differ materially from those expressed in any forward-looking statements made by KU.

**The rates that KU charges customers, as well as other aspects of the business, are subject to significant and complex governmental regulation.** Federal and state entities regulate many aspects of utility operations, including financial and capital structure matters; siting and construction of facilities; rates, terms and conditions of service and operations; mandatory reliability and safety standards; accounting, depreciation and cost allocation methodologies; tax matters; acquisition and disposal of utility assets and securities and other matters. Such regulations may subject KU to higher operating costs or increased capital expenditures and failure to comply could result in sanctions or possible penalties. In any rate-setting proceedings, federal or state agencies, intervenors and other permitted parties may challenge KU's rate request and ultimately reduce, alter or limit the rates KU seeks.

**Transmission and interstate market activities of KU, as well as other aspects of the business, are subject to significant FERC regulation.** KU's business is subject to extensive regulation under the FERC covering matters including rates charged to transmission users, market-based or cost-based rates applicable to wholesale customers; interstate power market structure; construction and operation of transmission facilities; mandatory reliability standards; standards of conduct and affiliate restrictions and other matters. Existing FERC regulation, changes thereto or issuances of new rules or situations of non-compliance, including but not limited to the areas of market-based tariff authority, RSG resettlements in the MISO market, mandatory reliability standards and natural gas transportation regulation can affect the earnings, operations or other activities of KU.

**Changes in transmission and wholesale power market structures could increase costs or reduce revenues.** The resulting changes to transmission and wholesale power market structures and prices are not estimable and may result in unforeseen effects on energy purchases and sales, transmission and related costs or revenues. These can include commercial or regulatory changes affecting power pools, exchanges or markets in which KU participates.

**KU undertakes significant capital projects and is subject to unforeseen costs, delays or failures in such projects, as well as risk of full recovery of such costs.** The completion of these facilities without delays or cost overruns is subject to risks in many areas, including approval and licensing; permitting; land acquisition; construction problems or delays; increases in commodity prices or labor rates; contractor performance; weather and geological issues; and political, labor and regulatory developments.

**KU's costs of compliance with environmental laws are significant and are subject to continuing changes.** Extensive federal, state and local environmental regulations are applicable to KU's air emissions, water discharges and the management of hazardous and solid waste, among other areas; and the costs of compliance or alleged non-compliance cannot be predicted with certainty. In addition, costs may increase significantly if the requirements or scope of environmental laws or regulations, or similar rules, are expanded or changed from prior versions by the relevant agencies. Costs may take the form of increased capital or operating and maintenance expenses; monetary fines, penalties or forfeitures or other restrictions.

**KU's operating results are affected by weather conditions, including storms and seasonal temperature variations, as well as by significant man-made or accidental disturbances, including terrorism or natural disasters.** These weather or man-made factors can significantly affect KU's



finances or operations by changing demand levels; causing outages; damaging infrastructure or requiring significant repair costs; affecting capital markets or impacting future growth.

**KU is subject to operational and financial risks regarding potential developments concerning global climate change matters.** Such developments could include potential federal or state legislation or industry initiatives allocating or limiting GHG emissions; establishing costs or charges on GHG emissions or on fuels relating to such emissions; requiring GHG capture and sequestration; establishing renewable portfolio standards or generation fleet-diversification requirements to address GHG emissions; promoting energy efficiency and conservation; changes in transmission grid construction, operation or pricing to accommodate GHG-related initiatives; or other measures. KU's generation fleet is predominantly coal-fired and may be highly impacted by developments in this area. Compliance with any new laws or regulations regarding the reduction of GHG could result in significant changes to the Company's operations, significant capital expenditures by the Company and a significant increase in its cost of conducting business. KU may face strong competition for, or difficulty in obtaining, required GHG-compliance related goods and services, including construction services, emissions allowances and financing, insurance and other inputs relating thereto. Increases in KU's costs or prices of producing or selling electric power due to GHG-development could materially reduce or otherwise affect the demand, revenue or margin levels applicable to KU's power, thus affecting KU's financial condition or results of operations. For more information see Business and Note 9 of Notes to Financial Statements.

**KU is subject to physical, market and economic risks relating to potential climate change matters.** Climate change may produce changes in weather or other environmental conditions, including temperature or precipitation changes, such as warming or drought. These changes may affect farm and agriculturally-dependent businesses and activities, which are an important part of Kentucky's economy, and thus may impact consumer demand for electric power. Temperature increases could result in increased overall electricity volumes or peaks and precipitation changes could result in altered availability of water for plant cooling operations. These or other meteorological changes could lead to increased operating costs, capital expenses or power purchase costs by KU to meet such developments. Conversely, potential climate change could have a number of impacts tending to reduce demand or increase costs. Changes may entail more frequent or more intense storm activity, which, if severe, could temporarily disrupt regional economic conditions and affect electricity demand levels. As discussed in other risk factors, storm outages and damage often directly decrease revenues or increase expenses, due to reduced usage and higher restoration charges, respectively. GHG regulation could increase the cost of electric power, particularly power generated by fossil-fuels, and such increases could have a depressive effect on the regional economy. Reduced economic and consumer activity in KU's service area, both generally and specific to certain industries and consumers accustomed to previously low-cost power, could reduce demand for KU's electricity. Also, demand for KU's services could be similarly lowered should consumers' preferences or market factors move toward favoring energy efficiency, low-carbon power sources or reduced electric usage generally. For more information, see Business and Note 9 to Notes of Financial Statements.

**KU's business is subject to risks associated with local, national and worldwide economic conditions.** The consequences of a prolonged recession may include a lower level of economic activity and uncertainty or volatility regarding energy prices and the capital and commodity markets. A lower level of economic activity might result in a decline in energy consumption and slower customer growth, which may adversely affect KU's future revenues and growth. Instability in the financial markets, as a result of recession or otherwise, also may affect the cost of capital and KU's ability to raise capital. A deterioration of economic conditions may lead to decreased production by KU's industrial customers and, therefore, lower consumption of electricity. Decreased economic activity may also lead to fewer commercial and industrial customers and increased unemployment, which may in turn impact residential

customers' ability to pay. Further, worldwide economic activity has an impact on the demand for basic commodities needed for utility infrastructure. Changes in global demand may impact the ability to acquire sufficient supplies and the cost of those commodities may be higher than expected.

**KU's business is concentrated in the Midwest United States, specifically Kentucky.** Local and regional economic conditions, such as population growth, industrial growth or expansion and economic development, as well as the operational or financial performance of major industries or customers, can affect the demand for energy. Significant activities in KU's service territory include automotive; aluminum and steel smelting and fabrication; chemical processing; coal, mineral and ceramic-related activities; educational institutions; health care facilities; paper and pulp processing and water utilities.

**KU is subject to operational risks relating to its generating plants, transmission facilities, distribution equipment, information technology systems and other assets and activities.** Operation of power plants, transmission and distribution facilities, information technology systems and other assets and activities subjects KU to many risks, including the breakdown or failure of equipment; accidents; security breaches, viruses or outages affecting information technology systems; labor disputes; delivery/transportation problems and disruptions of fuel supply and performance below expected levels, which occurrences may impact the ability of KU to conduct its business efficiently or lead to increased costs, expenses or losses.

**KU is subject to liability risks relating to its generating, transmission, distribution and retail businesses.** Conduct of physical and commercial operations subjects KU to many risks, including risks of potential physical injury, property damage or other financial affects, caused to or caused by employees, customers, contractors, vendors, contractual or financial counter-parties and other third-parties.

**KU could be negatively affected by rising interest rates, downgrades to the Company's bond credit ratings or other negative developments in its ability to access capital markets.** In the ordinary course of business, KU is reliant upon adequate long-term and short-term financing means to fund its significant capital expenditures, debt interest or maturities and operating needs. As a capital-intensive business, KU is sensitive to developments in interest rate levels; credit rating considerations; insurance, security or collateral requirements; market liquidity and credit availability and refinancing steps necessary or advisable to respond to credit market changes. Changes in these conditions could result in increased costs to KU.

**KU is subject to commodity price risk, credit risk, counterparty risk and other risks associated with the energy business.** General market or pricing developments or failures by counterparties to perform their obligations relating to energy, fuels, other commodities, goods, services or payments could result in potential increased costs to KU.

**KU is subject to risks associated with defined benefit retirement plans, health care plans, wages and other employee-related matters.** Risks include adverse developments in legislation or regulation, future costs or funding levels, returns on investments, market fluctuations, interest rates and actuarial matters. Changes in health care rules, market practices or cost structures can affect KU's current or future funding requirements or liabilities. The Company is also subject to risk related to changing wage levels, whether related to collective bargaining agreements or employment market conditions, ability to attract and retain key personnel and changing costs of providing health care benefits.

**KU is subject to risks associated with federal and state tax regulations.** Changes in taxation as well as the inherent difficulty in quantifying potential tax effects of business decisions could negatively impact KU's results of operations. KU is required to make judgments in order to estimate its obligations to taxing authorities. These tax obligations include income, property, sales and use and employment-related taxes. KU also estimates its ability to utilize tax benefits and tax credits. Due to the revenue needs of the states and jurisdictions in which KU operates, various tax and fee increases may be proposed or considered. KU cannot predict whether legislation or regulation will be introduced or the effect on the Company of any such changes. If enacted, any changes could increase tax expense and could have a negative impact on KU's results of operations and cash flows.

## Legal Proceedings

### Rates and Regulatory Matters

For a discussion of current rates and regulatory matters, including base rate increase proceedings, TC2 proceedings, Kentucky Commission, Virginia Commission, FERC proceedings and other rates or regulatory matters affecting KU, see Notes 2 and 9 of Notes to Financial Statements.

### Environmental

For a discussion of environmental matters including potential coal combustion byproduct or ash pond regulation, additional reductions in SO<sub>2</sub>, NO<sub>x</sub> and other regulated emissions; notices of violations and other emissions proceedings; environmental permit challenges and other environmental items affecting KU, see Risk Factors, and Notes 2 and 9 of Notes to Financial Statements.

### Climate Change

For a discussion of matters relating to potential climate change, GHG-emission or global warming developments, including increased legislative and regulatory activity which could limit or increase costs applicable to fossil-fuel generation sources, legal proceedings claiming damages relating to global warming, GHG-reporting requirements and other matters, see Business, Risk Factors, Management's Discussion and Analysis and Note 9 of Notes to Financial Statements.

### Litigation

For a discussion of litigation matters, see Note 9 of Notes to Financial Statements.

### Other

In the normal course of business, other lawsuits, claims, environmental actions and other governmental proceedings arise against KU. To the extent that damages are assessed in any of these lawsuits, the Company believes that its insurance coverage is adequate. Management, after consultation with legal counsel, does not anticipate that liabilities arising out of currently pending or threatened lawsuits and claims will have a material adverse effect on KU's financial position or results of operations.

### Selected Financial Data

(in millions)	<u>Years Ended December 31</u>				
	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Operating revenues	<u>\$ 1,355</u>	<u>\$ 1,405</u>	<u>\$ 1,272</u>	<u>\$ 1,210</u>	<u>\$ 1,207</u>
Net operating income	<u>\$ 269</u>	<u>\$ 260</u>	<u>\$ 267</u>	<u>\$ 235</u>	<u>\$ 202</u>
Net income	<u>\$ 133</u>	<u>\$ 158</u>	<u>\$ 167</u>	<u>\$ 152</u>	<u>\$ 112</u>
Total assets	<u>\$ 4,956</u>	<u>\$ 4,518</u>	<u>\$ 3,796</u>	<u>\$ 3,148</u>	<u>\$ 2,756</u>
Long-term obligations (including amounts due within one year)	<u>\$ 1,682</u>	<u>\$ 1,532</u>	<u>\$ 1,264</u>	<u>\$ 843</u>	<u>\$ 746</u>

Management's Discussion and Analysis and Notes to Financial Statements should be read in conjunction with the above information.

## Management's Discussion and Analysis

The following discussion and analysis by management focuses on those factors that had a material effect on KU's financial results of operations and financial condition during 2009, 2008 and 2007, and should be read in connection with the financial statements and notes thereto.

### Forward Looking Statements

Some of the following discussion may contain forward-looking statements that are subject to risks, uncertainties and assumptions. Such forward-looking statements are intended to be identified in this document by the words "anticipate," "expect," "estimate," "objective," "possible," "potential" and similar expressions. Actual results may materially vary. Factors that could cause actual results to materially differ include, but are not limited to: general economic conditions; business and competitive conditions in the energy industry; changes in federal or state legislation; unusual weather; actions by state or federal regulatory agencies; actions by credit rating agencies and other factors described from time to time in KU's reports, including those noted in the Risk Factors section of this report.

### RESULTS OF OPERATIONS

The electric utility business is affected by seasonal temperatures. As a result, operating revenues (and associated operating expenses) are not generated evenly throughout the year.

#### Net Income

Net income in 2009 decreased \$25 million compared to 2008. The decrease was primarily the result of decreased operating revenues (\$50 million), decreased equity in earnings (\$29 million), decreased other income – net (\$3 million) and increased interest expense (\$3 million), partially offset by decreased operating expenses (\$59 million) and decreased income taxes (\$1 million).

Net income in 2008 decreased \$9 million compared to 2007. The decrease was primarily the result of increased operating expenses (\$140 million) and increased interest expense (\$16 million), partially offset by increased operating revenues (\$133 million), decreased income taxes (\$9 million), increased equity in earnings (\$4 million) and increased other income – net (\$1 million).

#### Revenues

Revenues in 2009 decreased \$50 million primarily due to:

- Decreased wholesale sales (\$75 million) due to lower sales volumes to LG&E (\$60 million) and third-parties (\$16 million). These lower volumes were primarily due to lower economic demand caused by low spot market pricing during most of 2009, and due to higher scheduled coal-fired generation unit outages during 2009. Via a mutual agreement, KU sells its higher cost electricity to LG&E for its wholesale sales and KU purchases LG&E's lower cost electricity to serve its native load. These decreases were partially offset by increased prices (\$1 million) for sales to LG&E due to the higher cost of fuel inventory.
- Decreased retail sales volumes delivered (\$55 million) due to reduced consumption by residential customers as a result of milder weather and significant 2009 storm outages as well as low energy usage by industrial and commercial customers as a result of weakened economic conditions
- Decreased fuel costs billed to customers through the FAC (\$2 million) due to a refund of power purchased costs from OMU (\$6 million), partially offset by increased fuel prices (\$4 million)
- Decreased gains in unrealized energy marketing financial swaps (\$2 million)

Partially offset by:

- Increased ECR surcharge (\$50 million) due to increased recoverable capital spending
- Decreased merger surcredit (\$13 million) due to the surcredit termination in February 2009
- Increased DSM cost recovery (\$9 million) due to increased recoverable program spending
- Increased miscellaneous revenue (\$6 million) resulting from the assessment of late payment fees beginning in the second quarter of 2009
- Increased retail sales revenue from base rates (\$5 million) due to the increase in Virginia rates in November 2009, and application of the Kentucky base rate settlement resulting in higher customer charge and demand revenue, partially offset by lower energy revenue
- Decreased VDT surcredit (\$1 million) due to termination in August 2008

Revenues in 2008 increased \$133 million primarily due to:

- Increased fuel costs billed to customers through the FAC (\$52 million) due to increased fuel prices
- Increased wholesale sales (\$48 million) due to higher sales volumes and prices. Volumes increased to LG&E (\$34 million) and third-parties (\$10 million) as a result of excess generation made available by LG&E via a mutual agreement. KU sells its higher cost electricity to LG&E for LG&E to make wholesale sales and KU purchases LG&E's lower cost electricity to serve KU's native load. Both KU and LG&E experienced lower native load requirements due to milder weather and the weakening economy, and increased generation due to fewer scheduled coal-fired generation unit outages during 2008, resulting in higher volumes available for wholesale sales. Pricing to third-parties increased as a result of higher fuel costs (\$2 million). Wholesale sales also increased due to gains in energy marketing financial swaps (\$2 million).
- Increased ECR surcharge (\$43 million) due to increased recoverable capital spending
- Increased DSM cost recovery (\$2 million) due to additional conservation programs
- Increased transmission sales (\$2 million) due to higher sales to LG&E
- Decreased merger surcredit (\$2 million) due to a lower rate approved by the Kentucky Commission in June 2008
- Decreased VDT surcredit (\$1 million) due to its termination in August 2008

Partially offset by:

- Decreased retail sales volumes delivered (\$17 million) due to 26% decrease in cooling degree days and weakening economic conditions

## Expenses

Fuel for electric generation comprises a large component of total operating expenses. Increases or decreases in the cost of fuel are reflected in retail rates through the FAC, subject to the approval of the Kentucky Commission, the Virginia Commission and the FERC.

Fuel for electric generation decreased \$79 million in 2009 primarily due to:

- Decreased volumes of fuel usage (\$97 million) due to decreased native load and wholesale sales

Partially offset by:

- Increased commodity and transportation costs for coal (\$18 million)

Fuel for electric generation increased \$52 million in 2008 primarily due to:

- Increased commodity and transportation costs for coal and natural gas (\$39 million)
- Increased generation (\$13 million) due to increased utilization of coal-fired generation units as a result of fewer scheduled outages in 2008

Power purchased expense decreased \$22 million in 2009 primarily due to:

- Decreased prices for purchases used to serve retail customers (\$18 million) due to lower spot market pricing and increased availability of power from OMU
- Decreased purchases from LG&E due to lower prices (\$7 million) and lower volumes (\$2 million). Via a mutual agreement, KU purchases LG&E's lower cost electricity to serve KU's native load. LG&E provided lower volumes due to its increased scheduled coal-fired outages during the fourth quarter of 2009.
- Decreased power purchased expense (\$6 million) due to a refund of power purchased costs related to the OMU settlement

Partially offset by:

- Increased third-party purchased volumes for native load (\$8 million) primarily due to scheduled coal-fired generation unit outages
- Increased demand payments for third-party purchases (\$3 million) on long-term contracts

Power purchased expense increased \$53 million in 2008 primarily due to:

- Increased prices for purchases used to serve retail customers (\$24 million) due to higher market prices, influenced by higher fuel costs
- Increased power purchased from LG&E via a mutual agreement due to higher volumes (\$8 million) and higher prices (\$8 million). KU purchases LG&E's lower cost electricity to serve KU's native load. LG&E was able to provide higher volumes due to its reduced native load requirements as a result of milder weather and the weakening economy.
- Increased demand payments (\$7 million) for energy purchased on a long-term contract
- Increased third-party power purchase volume for native load (\$5 million) due to increased unscheduled coal-fired generation unit outages
- Increased expenses (\$1 million) due to activities in the PJM market for the entire year of 2008 compared to only one quarter in 2007

Other operation and maintenance expenses increased \$45 million in 2009 primarily due to increased other operation expenses (\$30 million) and increased other maintenance expenses (\$15 million).

Other operation expenses increased \$30 million in 2009 primarily due to:

- Increased pension expense (\$20 million) due to lower 2008 pension asset investment performance
- Increased steam expense (\$7 million) due to utilization of SCRs year-round
- Increased administrative and general expense (\$5 million) due to increased DSM program spending as well as consulting fees for software training and increased labor and benefit costs, partially offset by decreased legal expenses mainly related to OMU in 2008, which case was settled in the second quarter of 2009

Partially offset by:

- Decreased generation expense (\$2 million) due to scheduled unit outages and routine maintenance



Other maintenance expenses increased \$15 million in 2009 primarily due to:

- Increased steam expense (\$7 million) due to increased scope of work for scheduled outages
- Increased distribution expense (\$5 million) as a result of increased repairs and higher tree trimming expense in 2009 (\$3 million) and higher storm related expense in 2009 (\$2 million)
- Increased transmission expense (\$2 million) primarily due to increased overhead line maintenance for NERC mandatory reliability compliance
- Increased administrative and general expense (\$1 million) due to increased labor and system maintenance contracts resulting from completion of a significant in-house customer information system project

Other operation and maintenance expenses increased \$20 million in 2008 primarily due to increased other operation expenses (\$16 million) and increased maintenance expenses (\$4 million).

Other operation expenses increased \$16 million in 2008 primarily due to:

- Increased outside services (\$4 million) due to increased legal expenses as a result of on-going litigation, mainly with OMU
- Increased cost of consumables (\$4 million) due to contract pricing and commissioning and start up costs of FGDs
- Increased transmission expense (\$2 million) due to increased native load purchases from LG&E and the additional costs to comply with growing SERC and NERC Mandatory Reliability Standards
- Increased distribution expense (\$2 million) due to storm restoration
- Increased uncollectible accounts (\$2 million) due to the weakening economy
- Increased property taxes (\$2 million) due to net decrease in expense in 2007 as a result of the application of coal tax credits

Other maintenance expenses increased \$4 million in 2008 primarily due to increased maintenance of overhead conductors and devices (\$4 million) resulting from storm restoration.

Equity earnings in EEI decreased \$29 million in 2009 primarily due to lower earnings resulting from decreased market prices.

Equity earnings in EEI increased \$4 million in 2008 primarily due to an increased average price per Mwh sold in 2008 over the price for 2007.

Other income – net decreased \$3 million in 2009 primarily due to:

- Decreased \$2 million due to discontinuance of allowance for funds used during construction on ECR projects as a result of the FERC rate case
- Decreased \$1 million due mainly to depreciation expense on joint-use assets related to TC2 transferred from LG&E and currently held for future use

Other income – net increased \$1 million in 2008 primarily due to:

- Increased \$3 million due to allowance for funds used during construction related to several large multi-year projects
- Increased \$1 million due to net losses on the sale of property in 2007

Partially offset by:

- Decreased \$2 million due to lower income earned on bond deposits for special projects
- Decreased \$1 million due to settlement for Brown Station new source review litigation and related programs

Interest expense increased \$3 million in 2009 primarily due to increased interest expense to affiliated companies (\$13 million) resulting from additional debt, partially offset by decreased interest expense (\$8 million) due to lower interest rates on bonds and (\$2 million) due to lower interest rates on intercompany short term borrowings.

Interest expense increased \$16 million in 2008 primarily due to increased interest expense to affiliated companies (\$17 million) due to additional debt, partially offset by decreased interest expense (\$1 million) due to interest received on reacquired debt.

## CRITICAL ACCOUNTING POLICIES/ESTIMATES

Preparation of financial statements and related disclosures in compliance with generally accepted accounting principles requires the application of appropriate technical accounting rules and guidance, as well as the use of estimates. The application of these policies necessarily involves judgments regarding future events, including legal and regulatory challenges and anticipated recovery of costs. These judgments could materially impact the financial statements and disclosures based on varying assumptions, which may be appropriate to use. In addition, the financial and operating environment also may have a significant effect, not only on the operation of the business, but on the results reported through the application of accounting measures used in preparing the financial statements and related disclosures, even if the nature of the accounting policies applied has not changed. Specific risks for these critical accounting policies are described in the Notes to Financial Statements. Each of these has a higher likelihood of resulting in materially different reported amounts under different conditions or using different assumptions. Events rarely develop exactly as forecasted and the best estimates routinely require adjustment.

Critical accounting policies and estimates including unbilled revenue, allowance for doubtful accounts, regulatory mechanisms, pension and postretirement benefits and income taxes are detailed in Notes 1, 2, 5, 6 and 9 of Notes to Financial Statements.

**Recent Accounting Pronouncements.** Recent accounting pronouncements affecting KU are detailed in Note 1 of Notes to Financial Statements.

## LIQUIDITY AND CAPITAL RESOURCES

KU uses net cash generated from its operations, external financing (including financing from affiliates) and/or infusions of capital from its parent mainly to fund construction of plant and equipment. As of December 31, 2009, KU had a working capital deficiency of \$202 million, primarily due to the terms of certain tax-exempt bonds which allow the investors to put the bonds back to the Company causing them to be classified as current portion of long-term debt. The Company has adequate liquidity facilities to repurchase any bonds put back to the Company. See Note 7 of Notes to Financial Statements. Working capital deficiencies can be funded through an intercompany money pool agreement or through bilateral lines of credit. See Note 8 of Notes to Financial Statements. KU believes that its sources of funds will be sufficient to meet the needs of its business in the foreseeable future.

E.ON U.S. sponsors pension and postretirement benefit plans for its employees. The performance of the capital markets affects the values of the assets that are held in trust to satisfy future obligations under the defined benefit pension plans. The market value of the combined investments, including the impact of benefit payments, within the plans increased by approximately 15% for the year ended December 31, 2009. The benefit plan assets and obligations of E.ON U.S. and KU are remeasured annually using a December 31 measurement date. Investment gains in 2009 resulted in a decrease to the plans' unfunded status upon actuarial revaluation of the plans, while investment losses in 2008 had the opposite effect. The Company's 2009 pension cost was approximately \$20 million higher than 2008. The Company anticipates its 2010 pension cost will be approximately \$5 million less than the 2009 expense. The amount of future funding will depend upon the actual return on plan assets, the discount rate and other factors, but the Company funds its pension obligations in a manner consistent with the Pension Protection Act of 2006. In January 2010, the Company made a voluntary contribution to its pension plan of \$13 million.

## Operating Activities

Cash provided by operations in 2009 was \$39 million less than cash provided by operations in 2008 and was primarily the result of decreases in cash due to changes in:

- Storm restoration expenses (\$55 million) deferred for future recovery as regulatory assets
- Accounts receivable (\$16 million) due to timing of payments received from IMEA and IMPA in 2008
- Pension and postretirement funding (\$15 million) due to increased contributions made in 2009
- Accounts payable (\$12 million) primarily due to fuel purchases and timing of payments
- Prepayment and other current assets (\$2 million)

These decreases were partially offset by increases in cash due to changes in:

- Earnings, net of non-cash items (\$49 million)
- Materials and supplies (\$5 million) primarily due to a decrease in cash used for coal inventory
- Other (\$4 million)
- Other current liabilities (\$3 million)

Cash provided by operations in 2008 was \$19 million less than cash provided by operations in 2007 and was primarily the result of decreases in cash due to changes in:

- Materials and supplies (\$55 million) primarily due to increased fuel inventory volumes and higher fuel costs
- Earnings, net of non-cash items (\$15 million)
- Other (\$12 million) primarily due to changes in utility plant and customer advances for construction
- Prepayment and other current assets (\$2 million)
- Wind storm regulatory asset (\$2 million) due to new regulatory asset for Hurricane Ike restoration expenses

These decreases were partially offset by increases in cash due to changes in:

- Accounts receivable (\$28 million) due to timing of payments received from IMEA and IMPA
- Accounts payable (\$24 million) primarily due to construction accruals related to FGD projects and TC2
- Pension and postretirement funding (\$14 million) due to contributions made in 2007
- Other current liabilities (\$1 million)

## Investing Activities

The primary use of funds for investing activities continues to be for capital expenditures. Net cash used for investing activities decreased \$188 million in 2009 compared to 2008 primarily due to decreased capital expenditures of \$170 million, assets purchased from LG&E of \$10 million in 2008 and changes in restricted cash from bonds issued in 2008 used to fund environmental equipment of \$8 million. Restricted cash represents the escrowed proceeds of the pollution control bonds, which are disbursed as qualifying costs are incurred.

Net cash used for investing activities decreased \$42 million in 2008 compared to 2007 primarily due to decreased capital expenditures of \$63 million, partially offset by decreased restricted cash of \$11 million and an asset purchased from LG&E of \$10 million. Restricted cash represents the escrowed proceeds of the pollution control bonds, which are disbursed as qualifying costs are incurred.

## Financing Activities

Net cash provided by financing activities decreased \$151 million in 2009 compared to 2008, due to decreased long-term borrowings from affiliated company of \$100 million, lower equity contributions in 2009 of \$70 million, reduced issuance of tax-exempt bonds in 2009 totaling \$17 million, all of which were partially offset by an increase of short-term borrowing from affiliate of \$36 million.

Net cash provided by financing activities decreased \$15 million in 2008 compared to 2007, due to decreased long-term borrowings from affiliated company of \$198 million, reacquisition of bonds of \$80 million, retirement of pollution control bonds of \$60 million and issuance of pollution control bonds of \$1 million, partially offset by the retirement of first mortgage bonds of \$107 million in 2007, increased infusions from E.ON U.S. of \$70 million, decreased repayment of short-term borrowings from affiliate – net of \$67 million, reissuance of reacquired bonds of \$63 million and retirement of reacquired bonds of \$17 million.

See Note 7 of Notes to Financial Statements for information of redemptions, maturities and issuances of long-term debt.

## Future Capital Requirements

KU's construction program is designed to ensure that there will be adequate capacity and reliability to meet the electric needs of its service area and to comply with environmental regulations. These needs are continually being reassessed and appropriate revisions are made, when necessary, in construction schedules. KU expects its capital expenditures for the three-year period ending December 31, 2012 to total approximately \$1,180 million, consisting primarily of on-going construction related to generation assets totaling approximately \$285 million, ash pond and landfill projects totaling approximately \$260 million, on-going construction related to distribution assets totaling approximately \$245 million, SCR projects totaling approximately \$160 million, installation of FGDs on Ghent and Brown units totaling approximately \$145 million, information technology projects of approximately \$35 million, other projects of \$30 million and construction of TC2 totaling approximately \$20 million (including \$2 million for environmental controls). See Note 9 of Notes to Financial Statements for additional information.

Future capital requirements may be affected in varying degrees by factors such as electric energy demand load growth, changes in construction expenditure levels, rate actions by regulatory agencies, new legislation, changes in commodity prices and labor rates, changes in environmental regulations and other regulatory requirements. In particular, climate change initiatives may result in increasing and material future capital or operating funding requirements. These initiatives may be related to legislative, regulatory or market forces which require power generation from lower-carbon sources or require controls or emission allowances for power generation from higher-carbon sources. KU may require significant additional capital resources relating to any needed new plant and equipment or new contractual and operating arrangements necessary to comply with or conduct business effectively following such climate change developments. To the extent financial markets see climate change as a potential risk, KU may face reduced access to or increased costs in capital markets.

See the Contractual Obligations table below and Note 9 of Notes to Financial Statements for current commitments. KU anticipates funding future capital requirements through operating cash flow, debt and/or infusions of capital from its parent or other sources.

KU has a variety of funding alternatives available to meet its capital requirements. KU participates in an intercompany money pool agreement wherein E.ON U.S. and/or LG&E make funds of up to \$400 million available to the Company at market-based rates. Fidelia also provides long-term intercompany funding to KU. See Notes 7 and 8 of Notes to Financial Statements.

Regulatory approvals are required for KU to incur additional debt. The Virginia Commission and the FERC authorize the issuance of short-term debt while the Kentucky Commission, the Virginia Commission and the Tennessee Regulatory Authority authorize the issuance of long-term debt. In November 2009, KU received a two-year authorization from the FERC to borrow up to \$400 million in short-term funds. KU also has authorization from the Virginia Commission that expires at the end of 2011 allowing short-term borrowing of up to \$400 million. The Company currently believes this authorization provides the necessary flexibility to address any liquidity needs. As of December 31, 2009, KU has borrowed \$45 million of this authorized amount. See Note 8 of Notes to Financial Statements.

KU's debt ratings as of December 31, 2009, were:

	<u>Moody's</u>	<u>S&amp;P</u>
Unenhanced pollution control revenue bonds	A2	BBB+
Issuer rating	A2	-
Corporate credit rating	-	BBB+

These ratings reflect the views of Moody's and S&P. A security rating is not a recommendation to buy, sell or hold securities and is subject to revision or withdrawal at any time by the rating agency. See Note 7 of Notes to Financial Statements for a discussion of recent downgrade actions related to the pollution control revenue bonds caused by a change in the rating of the entity insuring those bonds.

#### Contractual Obligations

The following is provided to summarize contractual cash obligations for periods after December 31, 2009. KU anticipates cash from operations and external financing will be sufficient to fund future obligations. See Statements of Capitalization.

(in millions)	<u>Payments Due by Period</u>						
<u>Contractual Cash Obligations</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>Thereafter</u>	<u>Total</u>
Short-term debt (a)	\$ 45	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 45
Long-term debt (b)	33	-	50	175	100	1,324 (b)	1,682
Interest on long-term debt to affiliated company (c)	73	72	71	67	61	424	768
Interest on fixed rate bonds (d)	2	2	2	2	2	21	31
Operating leases (e)	7	6	5	4	4	3	29
Unconditional power purchase obligations (f)	16	10	10	11	12	177	236
Coal and gas purchase obligations (g)	391	307	145	88	92	-	1,023
Postretirement benefit plan obligations (h)	5	6	6	6	6	34	63
Other obligations (i)	57	5	-	-	-	-	62
Total contractual cash obligations	<u>\$ 629</u>	<u>\$ 408</u>	<u>\$ 289</u>	<u>\$ 353</u>	<u>\$ 277</u>	<u>\$ 1,983</u>	<u>\$ 3,939</u>

(a) Represents borrowings from affiliated company due within one year.

- (b) Includes long-term debt of \$228 million classified as current liabilities because these bonds are subject to tender for purchase at the option of the holder and to mandatory tender for purchase upon the occurrence of certain events. Maturity dates for these bonds range from 2023 to 2034.
- (c) Represents future interest payments on long-term debt to affiliated company.
- (d) Represents interest on fixed rate long-term bonds. Future interest obligations on variable rate long-term bonds cannot be quantified.
- (e) Represents future operating lease payments.
- (f) Represents future minimum payments under OMU and OVEC power purchase agreements through May 2010 and 2026, respectively.
- (g) Represents contracts to purchase coal and natural gas transportation. Obligations for 2015 and 2016 are indexed to future market prices and are not included above since prices will be set in the future using the contracted methodology.
- (h) Represents currently projected cash flows for the postretirement benefit plan as calculated by the actuary. For pension funding information see Note 5 of Notes to Financial Statements.
- (i) Represents construction commitments, including commitments for TC2 and the FGDs.

## CLIMATE CHANGE

Growing global, national and local attention to climate change matters may result in the direct or indirect regulation of GHGs, including carbon dioxide, which is emitted from the combustion of fossil fuels such as coal and natural gas, as occurs at KU's generating stations. While KU is not currently subject to limits, permits or charges on its GHG emissions, climate change developments will likely constitute a material trend affecting KU's business and operations during the foreseeable future. Substantial initiatives, although not yet finalized or binding, are underway at various international, federal, regional and state governmental or regulatory bodies, including the United Nations Framework Convention on Climate Change, pending legislation in the U.S. Congress and recent rulemaking proceedings at the U.S. EPA. These developments propose varying mechanisms and structures to regulate GHGs, including direct limits or caps, carbon allowances or taxes, renewable generation requirements or standards, energy efficiency or conservation measures, and may require investments in transmission, alternative fuel or carbon sequestration efforts, and other provisions. See, Business and Note 9 of Notes to Financial Statements.

The cost to KU and the effect on KU's business of complying with potential GHG restrictions will depend upon the details of the programs ultimately enacted. Some of the design elements which may have the greatest effect on KU include (a) the required levels and timing of any carbon caps or limits, (b) the emission sources covered by such caps or limits, (c) transition and mitigation provisions, such as phase-in periods, free allowances or price caps, (d) the availability and pricing of relevant GHG-reduction technologies, goods or services and (e) economic, market and customer reaction to electricity price and demand changes due to GHG limits.

These climate change developments could result in significant additional compliance or other costs, affect future unit retirement or replacement decisions, impact price levels of input commodities and output prices and affect supply and demand for electricity. While KU currently anticipates that many of such direct costs or effects may be recoverable through rates or other regulatory mechanisms, particularly with respect to coal-related generation, the availability, timing or completeness of such rate recovery cannot be assured. Ultimately, climate change matters could result in material effects on KU's results of operations, liquidity and financial position.

## CONTROLS AND PROCEDURES

Management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance

regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

KU is not subject to the internal control and other requirements of the Sarbanes-Oxley Act of 2002 and associated rules (the "Act") and consequently is not required to evaluate the effectiveness of the Company's internal control over financial reporting pursuant to Section 404 of the Act. However, management has assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2009, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control – Integrated Framework*. Management has concluded that, as of December 31, 2009, the Company's internal control over financial reporting was effective based on those criteria.

Effective April 1, 2009, the Company initiated a new software and data system for customer accounts and associated billing, management, operations and record-keeping aspects thereof, following a comprehensive planning, testing and implementation project. There were no changes to the Company's internal controls as a result of the new software implementation. There have been no changes in the Company's internal control over financial reporting that occurred during the twelve months ended December 31, 2009, that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2009, has been audited by PricewaterhouseCoopers LLP, an independent accounting firm, as stated in its report which is included in the 2009 KU Financial Statements and Additional Information.



Kentucky Utilities Company  
Statements of Income  
(Millions of \$)

	Years Ended December 31		
	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>OPERATING REVENUES:</b>			
Total operating revenues (Note 11).....	\$ 1,355	\$ 1,405	\$ 1,272
<b>OPERATING EXPENSES:</b>			
Fuel for electric generation .....	434	513	461
Power purchased (Notes 9 and 11).....	199	221	168
Other operation and maintenance expenses .....	320	275	255
Depreciation and amortization (Note 1).....	133	136	121
Total operating expenses.....	<u>1,086</u>	<u>1,145</u>	<u>1,005</u>
Net operating income.....	269	260	267
Equity in earnings of EEI (Note 1) .....	(1)	(30)	(26)
Other income - net .....	(5)	(8)	(7)
Interest expense (Notes 7 and 8).....	6	14	15
Interest expense to affiliated companies (Notes 8 and 11) .....	<u>69</u>	<u>58</u>	<u>41</u>
Income before income taxes .....	200	226	244
Federal and state income taxes (Note 6).....	<u>67</u>	<u>68</u>	<u>77</u>
Net income.....	<u>\$ 133</u>	<u>\$ 158</u>	<u>\$ 167</u>

The accompanying notes are an integral part of these financial statements.

Statements of Retained Earnings  
(Millions of \$)

	Years Ended December 31		
	<u>2009</u>	<u>2008</u>	<u>2007</u>
Balance January 1 .....	\$ 1,195	\$ 1,037	\$ 870
Add net income.....	133	158	167
Balance December 31 .....	<u>\$ 1,328</u>	<u>\$ 1,195</u>	<u>\$ 1,037</u>

The accompanying notes are an integral part of these financial statements.

Kentucky Utilities Company  
Balance Sheets  
(Millions of \$)

	December 31	
	<u>2009</u>	<u>2008</u>
ASSETS:		
Current assets:		
Cash and cash equivalents (Note 1) .....	\$ 2	\$ 2
Restricted cash (Note 1) .....	-	9
Accounts receivable, net: (Notes 1 and 11)		
Customer – less reserves of \$1 million and \$3 million as of December 31, 2009 and 2008, respectively .....	155	152
Other – less reserves of \$2 million and less than \$1 million as of December 31, 2009 and 2008 .....	27	32
Materials and supplies (Note 1):		
Fuel (predominantly coal) .....	98	73
Other materials and supplies .....	39	36
Deferred income taxes – net (Note 6) .....	3	2
Regulatory assets (Note 2) .....	32	32
Prepayments and other current assets .....	10	8
Total current assets .....	<u>366</u>	<u>346</u>
Other property and investments (Note 1) .....	12	23
Utility plant, at original cost (Note 1): .....	4,892	4,446
Less: reserve for depreciation .....	1,838	1,724
Total utility plant, net .....	<u>3,054</u>	<u>2,722</u>
Construction work in progress .....	1,257	1,176
Total utility plant and construction work in progress .....	<u>4,311</u>	<u>3,898</u>
Deferred debits and other assets:		
Regulatory assets (Note 2):		
Pension benefits .....	105	137
Other .....	117	64
Cash surrender value of key man life insurance .....	38	39
Other assets .....	7	11
Total deferred debits and other assets .....	<u>267</u>	<u>251</u>
Total Assets .....	<u>\$ 4,956</u>	<u>\$ 4,518</u>

The accompanying notes are an integral part of these financial statements.

Kentucky Utilities Company  
Balance Sheets (continued)  
(Millions of \$)

	December 31	
	<u>2009</u>	<u>2008</u>
<b>LIABILITIES AND EQUITY:</b>		
<b>Current liabilities:</b>		
Current portion of long-term debt (Note 7).....	\$ 261	\$ 228
Notes payable to affiliated companies (Notes 8 and 11).....	45	16
Accounts payable .....	107	155
Accounts payable to affiliated companies (Note 11) .....	88	38
Customer deposits .....	22	21
Regulatory liabilities (Note 2).....	3	5
Other current liabilities .....	42	34
<b>Total current liabilities .....</b>	<b><u>568</u></b>	<b><u>497</u></b>
<b>Long-term debt:</b>		
Long-term bonds (Note 7).....	123	123
Long-term debt to affiliated company (Notes 7 and 11) .....	1,298	1,181
<b>Total long-term debt .....</b>	<b><u>1,421</u></b>	<b><u>1,304</u></b>
<b>Deferred credits and other liabilities:</b>		
Accumulated deferred income taxes (Note 6).....	336	279
Accumulated provision for pensions and related benefits (Note 5) .....	160	186
Investment tax credit (Note 6).....	104	80
Asset retirement obligations.....	34	32
<b>Regulatory liabilities (Note 2):</b>		
Accumulated cost of removal of utility plant .....	331	329
Deferred income taxes .....	9	16
Postretirement benefits .....	9	10
Other .....	11	15
Other liabilities.....	21	26
<b>Total deferred credits and other liabilities .....</b>	<b><u>1,015</u></b>	<b><u>973</u></b>
<b>Commitments and contingencies (Note 9)</b>		
<b>COMMON EQUITY:</b>		
Common stock, without par value -		
Authorized 80,000,000 shares, outstanding 37,817,878 shares .....	308	308
Additional paid-in capital (Note 11) .....	316	241
Retained earnings.....	1,318	1,174
Undistributed subsidiary earnings.....	10	21
<b>Total retained earnings.....</b>	<b><u>1,328</u></b>	<b><u>1,195</u></b>
<b>Total common equity.....</b>	<b><u>1,952</u></b>	<b><u>1,744</u></b>
<b>Total Liabilities and Equity .....</b>	<b><u>\$ 4,956</u></b>	<b><u>\$ 4,518</u></b>

The accompanying notes are an integral part of these financial statements.

Kentucky Utilities Company  
Statements of Cash Flows  
(Millions of \$)

	Years Ended December 31		
	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income .....	\$ 133	\$ 158	\$ 167
Items not requiring cash currently:			
Depreciation and amortization.....	133	136	121
Deferred income taxes - net.....	50	(13)	(5)
Investment tax credit - net .....	24	25	42
Provision for pension and postretirement plans.....	26	10	11
Other .....	-	1	(4)
Change in certain current assets and liabilities:			
Accounts receivable.....	(4)	12	(16)
Materials and supplies .....	(28)	(33)	22
Prepayments and other current assets .....	(3)	(1)	1
Accounts payable.....	(3)	9	(15)
Other current liabilities.....	8	5	4
Pension and postretirement funding.....	(20)	(5)	(19)
Storm restoration regulatory asset.....	(57)	(2)	-
Other.....	(6)	(10)	2
Net cash provided by operating activities.....	<u>253</u>	<u>292</u>	<u>311</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Construction expenditures .....	(516)	(686)	(749)
Assets purchased from affiliate.....	-	(10)	-
Change in restricted cash .....	9	1	12
Net cash used for investing activities .....	<u>(507)</u>	<u>(695)</u>	<u>(737)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Long-term borrowings from affiliated company (Note 7) .....	150	250	448
Short-term borrowings from affiliated company – net (Note 8) .....	29	(7)	(74)
Retirement of first mortgage bonds.....	-	-	(107)
Issuance of pollution control bonds .....	-	77	78
Retirement of pollution control bonds .....	-	(60)	-
Acquisition of outstanding bonds.....	-	(80)	-
Reissuance of reacquired bonds .....	-	63	-
Retirement of reacquired bonds .....	-	17	-
Additional paid-in capital.....	75	145	75
Net cash provided by financing activities.....	<u>254</u>	<u>405</u>	<u>420</u>
Change in cash and cash equivalents.....	-	2	(6)
Cash and cash equivalents at beginning of year .....	2	-	6
Cash and cash equivalents at end of year .....	<u>\$ 2</u>	<u>\$ 2</u>	<u>\$ -</u>
<b>Supplemental disclosures of cash flow information:</b>			
Cash paid during the year for:			
Income taxes.....	\$ (9)	\$ 46	\$ 38
Interest on borrowed money .....	3	13	16
Interest to affiliated companies on borrowed money.....	67	53	29

The accompanying notes are an integral part of these financial statements.

Kentucky Utilities Company  
Statements of Capitalization  
(Millions of \$)

	December 31	
	<u>2009</u>	<u>2008</u>
LONG-TERM DEBT (Note 7):		
Pollution control series:		
Mercer Co. 2000 Series A, due May 1, 2023, variable % .....	\$ 13	\$ 13
Carroll Co. 2002 Series A, due February 1, 2032, variable %.....	21	21
Carroll Co. 2002 Series B, due February 1, 2032, variable %.....	2	2
Muhlenberg Co. 2002 Series A, due February 1, 2032, variable % .....	2	2
Mercer Co. 2002 Series A, due February 1, 2032, variable % .....	8	8
Carroll Co. 2002 Series C, due October 1, 2032, variable % .....	96	96
Carroll Co. 2004 Series A, due October 1, 2034, variable % .....	50	50
Carroll Co. 2006 Series B, due October 1, 2034, variable % .....	54	54
Carroll Co. 2007 Series A, due February 1, 2026, 5.75% .....	18	18
Trimble Co. 2007 Series A, due March 1, 2037, 6.0%.....	9	9
Carroll Co. 2008 Series A, due February 1, 2032, variable %.....	<u>78</u>	<u>78</u>
Total pollution control series .....	351	351
Notes payable to Fidelity:		
Due November 24, 2010, 4.24%, unsecured .....	33	33
Due January 16, 2012, 4.39%, unsecured.....	50	50
Due April 30, 2013, 4.55%, unsecured.....	100	100
Due August 15, 2013, 5.31%, unsecured.....	75	75
Due December 19, 2014, 5.45%, unsecured.....	100	100
Due July 8, 2015, 4.735%, unsecured.....	50	50
Due December 21, 2015, 5.36%, unsecured.....	75	75
Due October 25, 2016, 5.675%, unsecured .....	50	50
Due April 24, 2017, 5.28%, unsecured.....	50	-
Due June 20, 2017, 5.98%, unsecured.....	50	50
Due July 25, 2018, 6.16%, unsecured.....	50	50
Due August 27, 2018, 5.645%, unsecured.....	50	50
Due December 17, 2018, 7.035%, unsecured.....	75	75
Due July 29, 2019, 4.81%, unsecured.....	50	-
Due October 25, 2019, 5.71%, unsecured .....	70	70
Due November 25, 2019, 4.445%, unsecured .....	50	-
Due February 7, 2022, 5.69%, unsecured.....	53	53
Due May 22, 2023, 5.85%, unsecured .....	75	75
Due September 14, 2028, 5.96%, unsecured .....	100	100
Due June 23, 2036, 6.33%, unsecured.....	50	50
Due March 30, 2037, 5.86%, unsecured.....	<u>75</u>	<u>75</u>
Total notes payable to Fidelity .....	<u>1,331</u>	<u>1,181</u>
Total long-term debt outstanding.....	<u>1,682</u>	<u>1,532</u>
Less current portion of long-term debt .....	<u>261</u>	<u>228</u>
Long-term debt .....	<u>1,421</u>	<u>1,304</u>
COMMON EQUITY:		
Common stock, without par value -		
Authorized 80,000,000 shares, outstanding 37,817,878 shares .....	308	308
Additional paid-in-capital (Note 11) .....	316	241
Retained earnings.....	1,318	1,174
Undistributed subsidiary earnings.....	<u>10</u>	<u>21</u>
Total retained earnings.....	<u>1,328</u>	<u>1,195</u>
Total common equity .....	<u>1,952</u>	<u>1,744</u>
Total capitalization .....	<u>\$ 3,373</u>	<u>\$ 3,048</u>

The accompanying notes are an integral part of these financial statements.

Kentucky Utilities Company  
Notes to Financial Statements

**Note 1 - Summary of Significant Accounting Policies**

KU, incorporated in Kentucky in 1912 and in Virginia in 1991, is a regulated public utility engaged in the generation, transmission, distribution and sale of electric energy in Kentucky, Virginia and Tennessee. KU provides electric service to approximately 515,000 customers in 77 counties in central, southeastern and western Kentucky, to approximately 30,000 customers in 5 counties in southwestern Virginia and 5 customers in Tennessee. KU's service area covers approximately 6,600 square miles. Approximately 99% of the electricity generated by KU is produced by its coal-fired electric generating stations. The remainder is generated by a hydroelectric power plant and natural gas and oil fueled CTs. In Virginia, KU operates under the name Old Dominion Power Company. KU also sells wholesale electric energy to 12 municipalities.

KU is a wholly-owned subsidiary of E.ON U.S., an indirect wholly-owned subsidiary of E.ON, a German corporation. KU's affiliate, LG&E, is a regulated public utility engaged in the generation, transmission, distribution and sale of electric energy and the distribution and sale of natural gas in Kentucky.

Certain reclassification entries have been made to the previous years' financial statements to conform to the 2009 presentation with no impact on net assets, liabilities and capitalization or previously reported net income. However, for 2008 cash from operations was decreased by \$5 million and cash flows from investing increased by \$5 million and for 2007 cash from operations increased by \$4 million and cash flows from investing decreased by \$4 million.

**Regulatory Accounting.** KU is subject to the regulated operations guidance of the FASB ASC, under which regulatory assets are created based on expected recovery from customers in future rates to defer costs that would otherwise be charged to expense. Likewise, regulatory liabilities are created based on expected return to customers in future rates to defer credits that would otherwise be reflected as income, or, in the case of costs of removal, are created to match long-term future obligations arising from the current use of assets. The accounting for regulatory assets and liabilities is based on specific ratemaking decisions or precedent for each item as prescribed by the FERC, the Kentucky Commission or the Virginia Commission. See Note 2, Rates and Regulatory Matters, for additional detail regarding regulatory assets and liabilities.

**Cash and Cash Equivalents.** KU considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

**Restricted Cash.** Proceeds from bond issuances for environmental equipment (primarily related to the installation of FGDs) are held in trust pending expenditure for qualifying assets.

**Allowance for Doubtful Accounts.** The allowance for doubtful accounts included in customer accounts receivable is based on the ratio of the amounts charged-off during the last twelve months to the retail revenues billed over the same period multiplied by the retail revenues billed over the last four months. Accounts with no payment activity are charged-off after four months, although collection efforts continue thereafter. The allowance for doubtful accounts included in other accounts receivable is composed of accounts aged more than four months. Accounts are written off as management determines them uncollectible.

**Materials and Supplies.** Fuel and other materials and supplies inventories are accounted for using the average-cost method. Emission allowances are included in other materials and supplies. At December 31, 2009 and 2008, the emission allowances inventory was \$1 million and less than \$1 million, respectively.

**Other Property and Investments.** Other property and investments on the balance sheets consists of KU's investment in EEI, KU's investment in OVEC, funds related to the long-term power purchase contract with OMU and non-utility plant.

Although KU holds investment interests in OVEC and EEI, it is not the primary beneficiary, therefore, neither are consolidated into the Company's financial statements. KU and 10 other electric utilities are owners of OVEC, located in Piketon, Ohio. OVEC owns and operates two coal-fired power plants, Kyger Creek Station in Ohio and Clifty Creek Station in Indiana. OVEC's power is currently supplied to KU and 12 other companies affiliated with the various owners. Pursuant to current contractual agreements, KU owns 2.5% of OVEC's common stock and is contractually entitled to 2.5% of OVEC's output, approximately 55 Mw of generation capacity.

As of December 31, 2009 and 2008, KU's investment in OVEC totaled less than \$1 million and is accounted for under the cost method of accounting. The direct exposure to loss as a result of its involvement with OVEC is generally limited to the value of its investment. See Note 9, Commitments and Contingencies, for further discussion of developments regarding KU's ownership interests and power purchase rights.

KU owns 20% of the common stock of EEI, which owns and operates a 1,162-Mw generating station in southern Illinois. EEI, through a power marketer affiliated with its majority owner, sells its output to third parties. KU's investment in EEI is accounted for under the equity method of accounting and, as of December 31, 2009 and 2008, totaled \$12 million and \$22 million, respectively. KU's direct exposure to loss as a result of its involvement with EEI is generally limited to the value of its investment.

**Utility Plant.** Utility plant is stated at original cost, which includes payroll-related costs such as taxes, fringe benefits and administrative and general costs. Construction work in progress has been included in the rate base for determining retail customer rates in Kentucky. KU has not recorded a significant allowance for funds used during construction.

The cost of plant retired or disposed of in the normal course of business is deducted from plant accounts and such cost is charged to the reserve for depreciation. When complete operating units are disposed of, appropriate adjustments are made to the reserve for depreciation and gains and losses, if any, are recognized.

**Depreciation and Amortization.** Depreciation is provided on the straight-line method over the estimated service lives of depreciable plant. The amounts provided were approximately 2.6% in 2009, 3.0% in 2008 and 3.2% in 2007 of average depreciable plant. Of the amount provided for depreciation at December 31, 2009, approximately 0.4% was related to the retirement, removal and disposal costs of long lived assets. At December 31, 2008 and 2007, approximately 0.5% was related to the retirement, removal and disposal costs of long lived assets.

**Unamortized Debt Expense.** Debt expense is capitalized in deferred debits and amortized using the straight line method, which approximates the effective interest method, over the lives of the related bond issues.

**Income Taxes.** In accordance with the guidance of the FASB ASC, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, as measured by enacted tax rates that are expected to be in effect in the periods when the deferred tax assets and liabilities are expected to be settled or realized. Significant judgment is required in determining the provision for income taxes, and there are transactions for which the ultimate tax outcome is uncertain. The income taxes guidance of the FASB ASC prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Uncertain tax positions are analyzed periodically and adjustments are made when events occur to warrant a change. See Note 6, Income Taxes.

**Deferred Income Taxes.** Deferred income taxes are recognized at currently enacted tax rates for all material temporary differences between the financial reporting and income tax bases of assets and liabilities.

**Investment Tax Credits.** The EPAct 2005 added Section 48A to the Internal Revenue Code, which provides for an investment tax credit to promote the commercialization of advanced coal technologies that will generate electricity in an environmentally responsible manner. KU and LG&E received an investment tax credit related to the construction of a new base-load, coal-fired unit, TC2. See Note 6, Income Taxes. Investment tax credits prior to 2006 resulted from provisions of the tax law that permitted a reduction of KU's tax liability based on credits for construction expenditures. Deferred investment tax credits are being amortized to income over the estimated lives of the related property that gave rise to the credits.

**Revenue Recognition.** Revenues are recorded based on service rendered to customers through month-end. KU accrues an estimate for unbilled revenues from each meter reading date to the end of the accounting period based on allocating the daily system net deliveries between billed volumes and unbilled volumes. The allocation is based on a daily ratio of the number of meter reading cycles remaining in the month to the total number of meter reading cycles in each month. Each day's ratio is then multiplied by each day's system net deliveries to determine an estimated billed and unbilled volume for each day of the accounting period. The unbilled revenue estimates included in accounts receivable were \$76 million, \$60 million and \$59 million at December 31, 2009, 2008 and 2007, respectively.

**Fuel Costs.** The cost of fuel for generation is charged to expense as used. See Note 2, Rates and Regulatory Matters, for a description of the FAC.

**Management's Use of Estimates.** The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported assets and liabilities and disclosure of contingent items at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Accrued liabilities, including legal and environmental, are recorded when they are probable and estimable. Actual results could differ from those estimates.

**Recent Accounting Pronouncements.** The following are recent accounting pronouncements affecting KU:

#### Hierarchy of Generally Accepted Accounting Principles

The guidance related to the hierarchy of generally accepted accounting principles was issued in June 2009, and is effective for interim and annual periods ending after September 15, 2009. The guidance



establishes the FASB ASC as the single source of authoritative nongovernmental U.S. generally accepted accounting principles. It had no effect on the Company's results of operations, financial position or liquidity; however, references to authoritative accounting literature have changed with the adoption.

#### Subsequent Events

The guidance related to subsequent events was issued in May 2009, and is effective for interim and annual periods ending after June 15, 2009. This guidance requires disclosure of the date through which subsequent events have been evaluated, as well as whether that date is the date the financial statements were issued or the date they were available to be issued. The adoption of this guidance had no impact on the Company's results of operations, financial position or liquidity; however, additional disclosures were required with the adoption. See Note 12, Subsequent Events, for additional disclosures.

#### Interim Disclosures about Fair Value of Financial Instruments

The guidance related to interim disclosures about fair value of financial instruments was issued in April 2009, and is effective for interim and annual periods ending after June 15, 2009. This guidance requires qualitative and quantitative disclosures about fair values of assets and liabilities on a quarterly basis. The adoption had no impact on the Company's results of operations, financial position or liquidity; however, additional disclosures were required with the adoption. See Note 3, Financial Instruments, for additional disclosures.

#### Employers' Disclosures about Postretirement Benefit Plan Assets

The guidance related to employers' disclosures about postretirement benefit plan assets was issued in December 2008, and is effective as of December 31, 2009. This guidance requires additional disclosures related to pension and other postretirement benefit plan assets. Additional disclosures include the investment allocation decision-making process, the fair value of each major category of plan assets as well as the inputs and valuation techniques used to measure fair value and significant concentrations of risk within the plan assets. The adoption had no impact on the Company's results of operations, financial position or liquidity; however, additional disclosures were required with the adoption. See Note 5, Pension and Other Postretirement Benefit Plans, for additional disclosures.

#### Disclosures about Derivative Instruments and Hedging Activities

The guidance related to disclosures about derivative instruments and hedging activities was issued in March 2008, and is effective for fiscal years, and interim periods within those fiscal years, beginning on or after November 15, 2008. The objective of this guidance is to enhance the current disclosure framework. The adoption had no impact on KU's results of operations, financial position or liquidity; however, additional disclosures relating to derivatives were required with the adoption effective January 1, 2009. See Note 3, Financial Instruments, for additional disclosures.

## Noncontrolling Interests in Consolidated Financial Statements

The guidance related to noncontrolling interests in consolidated financial statements was issued in December 2007, and is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The objective of this guidance is to improve the relevance, comparability and transparency of financial information in a reporting entity's consolidated financial statements. The Company adopted this guidance effective January 1, 2009, and it had no impact on its results of operations, financial position or liquidity.

## Fair Value Measurements

In January 2010, the FASB issued guidance related to fair value measurement disclosures requiring separate disclosure of amounts of significant transfers in and out of level 1 and level 2 fair value measurements and separate information about purchases, sales, issuances, and settlements within level 3 measurements. This guidance is effective for the first reporting period beginning after issuance except for disclosures about the roll-forward of activity in level 3 fair value measurements. This guidance will have no impact on the Company's results of operations, financial position or liquidity; however, additional disclosures will be provided as required.

In August 2009, the FASB issued guidance related to fair value measurement disclosures, which is effective for the first reporting period beginning after issuance. The guidance provides amendments to clarify and reduce ambiguity in valuation techniques, adjustments and measurement criteria for liabilities measured at fair value. The adoption had no impact on the Company's results of operations, financial position or liquidity, and no additional disclosures were required.

The guidance related to fair value measurements was issued in September 2006 and, except as described below, was effective for fiscal years beginning after November 15, 2007. This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. This guidance does not expand the application of fair value accounting to new circumstances.

In February 2008, guidance on fair value measurements and disclosures delayed the effective date for all nonfinancial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. All other amendments have been evaluated and have no impact on the Company's financial statements.

The Company adopted this guidance effective January 1, 2008, except as it applies to those nonfinancial assets and liabilities, and it had no impact on the results of operations, financial position or liquidity, however, additional disclosures relating to its financial derivatives and cash collateral on derivatives, as required, are now provided. Fair value accounting for all nonrecurring fair value measurements of nonfinancial assets and liabilities was adopted effective January 1, 2009, and it had no impact on the results of operations, financial position or liquidity. At December 31, 2009, no additional disclosures were required as KU did not have any nonfinancial assets or liabilities measured at fair value subsequent to initial measurement.

The guidance related to determining fair value was issued in April 2009, and is effective for interim and annual periods ending after June 15, 2009. This update provides additional guidance on determining fair values when there is *no active market* or where the price inputs being used represent distressed sales. The adoption had no impact on the Company's results of operations, financial position or liquidity.

## **Note 2 - Rates and Regulatory Matters**

The Company is subject to the jurisdiction of the Kentucky Commission, the Virginia Commission, the Tennessee Regulatory Authority and the FERC in virtually all matters related to electric utility regulation, and as such, its accounting is subject to the regulated operations guidance of the FASB ASC. Given its position in the marketplace and the status of regulation in Kentucky and Virginia, there are no plans or intentions to discontinue the application of the regulated operations guidance of the FASB ASC.

### 2010 Kentucky Rate Case

In January 2010, KU filed an application with the Kentucky Commission requesting an increase in base electric rates of approximately 12%, or \$135 million annually, including an 11.5% return on equity. KU has requested the increase, based on the twelve month test year ended October 31, 2009, to become effective on and after March 1, 2010. The requested rates have been suspended until August 1, 2010, at which time they may be put into effect, subject to refund, if the Kentucky Commission has not issued an order in the proceeding. The parties are currently exchanging data requests in the proceedings and a hearing date has been scheduled for June 2010. An order in the proceeding may occur during the third or fourth quarters of 2010.

### 2008 Kentucky Rate Case

In July 2008, KU filed an application with the Kentucky Commission requesting an increase in base electric rates. In January 2009, KU, the AG, the KIUC and all other parties to the rate case filed a settlement agreement with the Kentucky Commission, under which KU's base electric rates decreased by \$9 million annually. An Order approving the settlement agreement was received in February 2009. The new rates were implemented effective February 6, 2009, at which time the merger surcredit terminated.

In conjunction with the filing of the application for changes in base rates the VDT surcredit terminated. The VDT surcredit resulted from a 2001 initiative to share savings of \$10 million from the VDT initiative with customers over five years. In February 2006, KU and all parties to the proceeding reached a unanimous settlement agreement on the future ratemaking treatment of the VDT surcredit which was approved by the Kentucky Commission in March 2006 at an annual rate of \$4 million. Under the terms of the settlement agreement, the VDT surcredit continued at its then current level until such time as KU filed for a change in base rates. In accordance with the Order, the VDT surcredit terminated in August 2008, the first billing month after the July 2008 filing for a change in base rates.

In December 2007, KU submitted its plan to allow the merger surcredit to terminate as scheduled on June 30, 2008. The merger surcredit originated as part of the LG&E Energy merger with KU Energy Corporation in 1998. In June 2008, the Kentucky Commission issued an Order approving a unanimous settlement agreement reached with all parties to the case which provided for a reduction in the merger surcredit to approximately \$6 million for a 7-month period beginning July 2008, termination of the merger surcredit when new base rates went into effect on or after January 31, 2009, and that the merger surcredit be continued at an annual rate of \$12 million thereafter should the Company not file for a change in base rates. In accordance with the Order, the merger surcredit was terminated effective February 6, 2009, with the implementation of new base rates.

### Virginia Rate Case

In June 2009, KU filed an application with the Virginia Commission requesting an increase in electric base rates for its Virginia jurisdictional customers in an amount of \$12 million annually or approximately 21%. The proposed increase reflected a proposed rate of return on rate base of 8.586% based upon a return on equity of 12%. During December 2009, KU and the Virginia Commission Staff agreed to a Stipulation and Recommendation authorizing base rate revenue increases of \$11 million annually and a return on rate base of 7.846% based on a 10.5% return on common equity. A public hearing was held during January 2010. As permitted, pursuant to a Virginia Commission order, KU elected to implement the proposed rates effective November 1, 2009, on an interim basis. In March 2010, the Virginia Commission issued an Order approving the stipulation, with the increased rates to be put into effect as of April 1, 2010. As part of the stipulation, KU will refund certain amounts collected since November 2009, consisting of interim increased rates in excess of the ultimate approved rates. These refunds aggregate approximately \$1 million and are anticipated to occur during the second quarter of 2010. See also Note 12 to Notes to Financial Statements.

### FERC Wholesale Rate Case

In September 2008, KU filed an application with the FERC for increases in base electric rates applicable to wholesale power sales contracts or interchange agreements involving, collectively, twelve Kentucky municipalities. The application requested a shift from current, all-in stated unit charge rates to an unbundled formula rate. In May 2009, as a result of settlement negotiations, KU submitted an unopposed motion informing the FERC of the filing of a settlement agreement and agreed-upon seven-year service agreements with the municipal customers. The unopposed motion requested interim rate structures containing terms corresponding to the overall settlement principles, to be effective from May 1, 2009, until FERC approval of the settlement agreement. The settlement and service agreements provide for unbundled formula rates which are subject to annual adjustment and approval processes. In May 2009, the FERC issued an Order approving the interim settlement with respect to rates effective May 1, 2009 representing increases of approximately 3% from prior charges and a return on equity of 11%. Additionally, during May 2009, KU filed the first annual adjustment to the formula rates to incorporate 2008 data, which adjusted formula rates became effective on July 1, 2009 and were approved by the FERC during September 2009.

Separately, the parties were not able to reach agreement on the issue of whether KU must allocate to the municipal customers a portion of renewable resources it may be required to procure on behalf of its retail ratepayers. In August 2009, the FERC accepted the issue for briefing and the parties completed briefing submissions during 2009. An order by the FERC on this matter may occur during 2010. KU is not currently able to predict the outcome of this proceeding, including whether its wholesale customers may or may not be entitled to certain rights or benefits relating to renewable energy, and the financial or operational effects, if any, of such outcomes.

## Regulatory Assets and Liabilities

The following regulatory assets and liabilities were included in the balance sheets as of December 31:

(in millions)	<u>2009</u>	<u>2008</u>
Current regulatory assets:		
ECR	\$ 28	\$ 20
FAC	1	8
Net MISO exit	2	-
Other	1	4
Total current regulatory assets	<u>\$ 32</u>	<u>\$ 32</u>
Non-current regulatory assets:		
Storm restoration	\$ 59	\$ 2
ARO	30	28
Unamortized loss on bonds	12	13
Net MISO exit	9	19
Other	7	2
Subtotal non-current regulatory assets	<u>117</u>	<u>64</u>
Pension benefits	<u>105</u>	<u>137</u>
Total non-current regulatory assets	<u>\$ 222</u>	<u>\$ 201</u>
Current regulatory liabilities:		
DSM	\$ 3	\$ 5
Total current regulatory liabilities	<u>\$ 3</u>	<u>\$ 5</u>
Non-current regulatory liabilities:		
Accumulated cost of removal of utility plant	\$ 331	\$ 329
Deferred income taxes – net	9	16
Postretirement benefits	9	10
Other	11	15
Total non-current regulatory liabilities	<u>\$ 360</u>	<u>\$ 370</u>

KU does not currently earn a rate of return on the ECR and FAC regulatory assets and the Virginia levelized fuel factor included in other regulatory assets, which are separate recovery mechanisms with recovery within twelve months. No return is earned on the pension regulatory asset that represents the changes in funded status of the plans. KU will recover this asset through pension expense included in the calculation of base rates with the Kentucky Commission and will seek recovery of this asset in future proceedings with the Virginia Commission. No return is currently earned on the ARO asset. When an asset with an ARO is retired, the related ARO regulatory asset will be offset against the associated ARO regulatory liability, ARO asset and ARO liability. A return is earned on the unamortized loss on bonds, and these costs are recovered through amortization over the life of the debt. The Company is seeking recovery of the Storm restoration regulatory asset and CMRG and KCCS contributions and FERC jurisdictional pension expense, included in other regulatory assets, in its current base rate cases. The Company recovers through the calculation of base rates, the amortization of the net MISO exit regulatory asset in Kentucky incurred through April 30, 2008. The Company recently received approval to recover the Virginia portion of this asset, as incurred through December 31, 2008, over a five year

period and, due to the formula nature of its FERC rate structure, the FERC jurisdictional portion of the regulatory asset will be included in the annual updates to the rate formula. The Company recovers through the calculation of base rates, the amortization of the remaining regulatory assets, including other regulatory assets comprised of deferred storm costs, the East Kentucky Power Cooperative FERC transmission settlement agreement and Kentucky rate case expenses. Other regulatory liabilities include DSM, FERC jurisdictional supplies inventory and MISO administrative charges collected via base rates from May 2008 through February 5, 2009. The MISO regulatory liability will be netted against the remaining costs of withdrawing from the MISO, per a Kentucky Commission Order, in the current Kentucky base rate case.

**ARO.** A summary of KU's net ARO assets, regulatory assets, ARO liabilities, regulatory liabilities and cost of removal established under the asset retirement and environmental obligations guidance of the FASB ASC, follows:

	ARO Net <u>Assets</u>	ARO <u>Liabilities</u>	Regulatory <u>Assets</u>	Regulatory <u>Liabilities</u>	Accumulated <u>Cost of Removal</u>	Cost of Removal <u>Depreciation</u>
As of December 31, 2006	\$ 5	\$ (28)	\$ 22	\$ (2)	\$ 2	\$ 1
ARO accretion	-	(2)	2	-	-	-
As of December 31, 2007	\$ 5	\$ (30)	\$ 24	\$ (2)	\$ 2	\$ 1
ARO accretion	-	(2)	2	-	-	-
Removal cost reclass	-	-	2	(2)	-	-
As of December 31, 2008	5	(32)	28	(4)	2	1
ARO accretion	-	(2)	2	-	-	-
ARO depreciation	(1)	-	-	-	-	-
Cost of removal depreciation	-	-	-	-	-	1
As of December 31, 2009	<u>\$ 4</u>	<u>\$ (34)</u>	<u>\$ 30</u>	<u>\$ (4)</u>	<u>\$ 2</u>	<u>\$ 2</u>

Pursuant to regulatory treatment prescribed under the regulated operations guidance of the FASB ASC, an offsetting regulatory credit was recorded in depreciation and amortization in the income statement of \$2 million in 2009, 2008 and 2007 for the ARO accretion and depreciation expense. KU AROs are primarily related to the final retirement of assets associated with generating units. For assets associated with AROs, the removal cost accrued through depreciation under regulatory accounting is established as a regulatory liability pursuant to regulatory treatment prescribed under the regulated operations guidance of the FASB ASC. For the years ended December 31, 2008 and 2007, KU recorded less than \$1 million of depreciation expense related to the cost of removal of ARO related assets. An offsetting regulatory liability was established pursuant to regulatory treatment prescribed under the regulated operations guidance of the FASB ASC.

KU transmission and distribution lines largely operate under perpetual property easement agreements which do not generally require restoration upon removal of the property. Therefore, under the asset retirement and environmental obligations guidance of the FASB ASC, no material asset retirement obligations are recorded for transmission and distribution assets.

**MISO.** Following receipt of applicable FERC, Kentucky Commission and other regulatory orders, related to proceedings that had been underway since July 2003, KU withdrew from the MISO effective September 1, 2006. Since the exit from the MISO, KU has been operating under a FERC-approved open access-transmission tariff. KU now contracts with the Tennessee Valley Authority to act as its transmission Reliability Coordinator and Southwest Power Pool, Inc. to function as its Independent Transmission Organization, pursuant to FERC requirements.

KU and the MISO have agreed upon overall calculation methods for the contractual exit fee to be paid by the Company following its withdrawal. In October 2006, the Company paid \$20 million to the MISO and made related FERC compliance filings. The Company's payment of this exit fee was with reservation of its rights to contest the amount, or components thereof, following a continuing review of its calculation and supporting documentation. KU and the MISO resolved their dispute regarding the calculation of the exit fee and, in November 2007, filed an application with the FERC for approval of a recalculation agreement. In March 2008, the FERC approved the parties' recalculation of the exit fee, and the approved agreement provided KU with an immediate recovery of \$1 million and an estimated \$3 million over the next seven years for credits realized from other payments the MISO will receive, plus interest.

In accordance with Kentucky Commission Orders approving the MISO exit, KU has established a regulatory asset for the MISO exit fee, net of former MISO administrative charges collected via Kentucky base rates through the base rate case test year ended April 30, 2008. The net MISO exit fee is subject to adjustment for possible future MISO credits, and a regulatory liability for certain revenues associated with former MISO administrative charges, which were collected via base rates until February 6, 2009. The approved 2008 base rate case settlement provided for MISO administrative charges collected through base rates from May 1, 2008 to February 6, 2009, and any future adjustments to the MISO exit fee, to be established as a regulatory liability until the amounts can be amortized in future base rate cases. This regulatory liability balance as of October 31, 2009 has been included in the base rate case application filed on January 29, 2010. MISO exit fee credit amounts subsequent to October 31, 2009, will continue to accumulate as a regulatory liability until they can be amortized in future base rate cases.

In November 2008, the FERC issued Orders in industry-wide proceedings relating to MISO RSG calculation and resettlement procedures. RSG charges are amounts assessed to various participants active in the MISO trading market which generally seek to compensate for uneconomic generation dispatch due to regional transmission or power market operational considerations, with some customer classes eligible for payments, while others may bear charges. The FERC Orders approved two requests for significantly altered formulas and principles, each of which the FERC applied differently to calculate RSG charges for various historical and future periods. Based upon the 2008 FERC Orders, the Company established a reserve during the fourth quarter of 2008 of less than \$1 million relating to potential RSG resettlement costs for the period ended December 31, 2008. However, in May 2009, after a portion of the resettlement payments had been made, the FERC issued an Order on the requests for rehearing on one November 2008 Order which changed the effective date and reduced almost all of the previously accrued RSG resettlement costs. Therefore, these costs were reversed and a receivable was established for amounts already paid of less than \$1 million, which the MISO began refunding back to the Company in June 2009, and which were fully collected by September 2009. In June 2009, the FERC issued an Order in the rate mismatch RSG proceeding, stating it will not require resettlements of the rate mismatch calculation from April 1, 2005 to November 4, 2007. An accrual had previously been recorded in 2008 for the rate mismatch issue for the time period April 25, 2006 to August 9, 2007, but no accrual had been recorded for the time period November 5, 2007 to November 9, 2008 based on the prior Order. Accordingly, the accrual for the former time period was reversed and an accrual for the latter time period was recorded in June 2009, with a net effect of \$1 million of expense, substantially all of which was paid by September 2009.

In August 2009, the FERC determined that the MISO had failed to demonstrate that its proposed exemptions to real-time RSG charges were just and reasonable. In November 2009, the MISO made a compliance filing incorporating the rulings of the FERC orders and a related task-force, with a primary

open issue being whether certain of the tariff changes are applied prospectively only or retroactively to approximately January 6, 2009. The conclusion of the RSG matter, including the retroactivity decision, may result in refunds to the Company, but the Company cannot predict the ultimate outcome of this matter, nor the financial impact, at this time.

In November 2009, KU and LG&E filed an application with the FERC to approve certain independent transmission operator arrangements to be effective upon the expiration of their current contract with Southwest Power Pool, Inc. in September 2010. The application seeks authority for KU and LG&E to function after such date as the administrators of their own open access transmission tariffs for most purposes. The Tennessee Valley Authority, which currently acts as Reliability Coordinator, would also assume certain additional duties. A number of parties have intervened and filed comments in the matter and initial stages of data response proceedings have occurred. The application is subject to continuing FERC proceedings, including further submissions or filings by intervenors or FERC staff, prior to a ruling by the FERC. During January 2010, the Kentucky Commission issued an Order generally authorizing relevant state regulatory aspects of the proposed arrangements.

**Unamortized Loss on Bonds.** The costs of early extinguishment of debt, including call premiums, legal and other expenses, and any unamortized balance of debt expense are amortized using the straight line method, which approximates the effective interest method, over the life of either the replacement debt (in the case of refinancing) or the original life of the extinguished debt.

**FAC.** KU's retail rates contain an FAC, whereby increases and decreases in the cost of fuel for generation are reflected in the rates charged to retail customers. The FAC allows the Company to adjust customers' accounts for the difference between the fuel cost component of base rates and the actual fuel cost, including transportation costs. Refunds to customers occur if the actual costs are below the embedded cost component. Additional charges to customers occur if the actual costs exceed the embedded cost component. The amount of the regulatory asset or liability is the amount that has been under- or over-recovered due to timing or adjustments to the mechanism.

The Kentucky Commission requires public hearings at six-month intervals to examine past fuel adjustments, and at two-year intervals to review past operations of the fuel clause and transfer of the then current fuel adjustment charge or credit to the base charges. In November 2009, January 2009, June 2008 and January 2008, the Kentucky Commission issued Orders approving the charges and credits billed through the FAC for the six-month periods ending April 2009, April 2008, October 2007 and April 2007, respectively. In January 2009 and December 2006, the Kentucky Commission initiated routine examinations of the FAC for the two-year periods November 1, 2006 through October 31, 2008 and November 1, 2004 through October 31, 2006. The Kentucky Commission issued Orders in June 2009 and November 2007, approving the charges and credits billed through the FAC during the review periods.

KU also employs an FAC mechanism for Virginia customers using an average fuel cost factor based primarily on projected fuel costs. The Virginia levelized fuel factor allows fuel recovery based on projected fuel costs for the coming year plus an adjustment for any over- or under-recovery of fuel expenses from the prior year. At December 31, 2009 and 2008, KU had a regulatory liability of less than \$1 million and a regulatory asset of \$2 million, respectively.

In February 2009, KU filed an application with the Virginia Commission seeking approval of a 29% increase in its fuel cost factor beginning with service rendered in April 2009. In February 2009, the Virginia Commission issued an Order allowing the requested change to become effective on an interim basis. The Virginia Staff testimony filed in April 2009, recommended a slight decrease in the factor filed



by KU. The Company indicated the Virginia Staff proposal was acceptable. A hearing was held in May 2009, with general resolution of remaining issues. In May 2009, the Virginia Commission issued an Order approving the revised fuel factor, representing an increase of 24%, effective May 2009.

In February 2008, KU filed an application with the Virginia Commission seeking approval of a decrease in its fuel cost factor applicable during the billing period, April 2008 through March 2009. The Virginia Commission allowed the new rates to be in effect for the April 2008 customer billings. In April 2008, the Virginia Commission Staff recommended a change to the fuel factor KU filed in its application, to which KU has agreed. Following a public hearing and an Order in May 2008, the recommended change became effective in June 2008, resulting in a decrease of 0.482 cents/kwh from the factor in effect for the April 2007 through March 2008 period.

**ECR.** Kentucky law permits KU to recover the costs of complying with the Federal Clean Air Act, including a return of operating expenses, and a return of and on capital invested, through the ECR mechanism. The amount of the regulatory asset or liability is the amount that has been under- or over-recovered due to timing or adjustments to the mechanism.

The Kentucky Commission requires reviews of the past operations of the environmental surcharge for six-month and two-year billing periods to evaluate the related charges, credits and rates of return, as well as to provide for the roll-in of ECR amounts to base rates each two-year period. In December 2009, an Order was issued approving the charges and credits billed through the ECR during the two-year period ending April 2009, an increase in the jurisdictional revenue requirement, a base rate roll-in and a revised rate of return on capital. In July 2009, an Order was issued approving the charges and credits billed through the ECR during the six-month period ending October 2008, as well as approving billing adjustments for under-recovered costs and the rate of return on capital. In August 2008, an Order was issued approving the charges and credits billed through the ECR during the six-month periods ending April 2008 and October 2007, and the rate of return on capital. In March 2008, an Order was issued approving the charges and credits billed through the ECR during the six-month and two-year periods ending October 2006 and April 2007, respectively, as well as approving billing adjustments, roll-in adjustments to base rates, revisions to the monthly surcharge filing and the rates of return on capital.

In January 2010, the Kentucky Commission initiated a six-month review of KU's environmental surcharge for the billing period ending October 2009. The proceeding will progress throughout the first half of 2010.

In June 2009, the Company filed an application for a new ECR plan with the Kentucky Commission seeking approval to recover investments in environmental upgrades and operations and maintenance costs at the Company's generating facilities. During 2009, KU reached a unanimous settlement with all parties to the case and the Kentucky Commission issued an Order approving KU's application. Recovery on customer bills through the monthly ECR surcharge for these projects began with the February 2010 billing cycle.

In February 2009, the Kentucky Commission approved a settlement agreement in the rate case which provides for an authorized return on equity applicable to the ECR mechanism of 10.63% effective with the February 2009 expense month filing, which represents a slight increase over the previously authorized 10.50%.

In October 2007, KU met with the Kentucky Commission and other interested parties to discuss the status of the Ghent Unit 2 SCR construction. KU informed the Kentucky Commission that construction of the Ghent Unit 2 SCR was not going to commence before the CCN expired in December 2007, due to

a change in the economics for the project. The CCN expired in December 2007, and KU has delayed construction of the Ghent Unit 2 SCR.

**Storm Restoration.** In January 2009, a significant ice storm passed through KU's service territory causing approximately 199,000 customer outages, followed closely by a severe wind storm in February 2009, causing approximately 44,000 customer outages. The Company filed an application with the Kentucky Commission in April 2009, requesting approval to establish a regulatory asset, and defer for future recovery, approximately \$62 million in incremental operation and maintenance expenses related to the storm restoration. In September 2009, the Kentucky Commission issued an Order allowing the Company to establish a regulatory asset of up to \$62 million based on its actual costs for storm damages and service restoration due to the January and February 2009 storms. In September 2009, the Company established a regulatory asset of \$57 million for actual costs incurred, and the Company is seeking recovery of this asset in its current base rate case.

In September 2008, high winds from the remnants of Hurricane Ike passed through the service territory causing significant outages and system damage. In October 2008, KU filed an application with the Kentucky Commission requesting approval to establish a regulatory asset, and defer for future recovery, approximately \$3 million of expenses related to the storm restoration. In December 2008, the Kentucky Commission issued an Order allowing the Company to establish a regulatory asset of up to \$3 million based on its actual costs for storm damages and service restoration due to Hurricane Ike. In December 2008, the Company established a regulatory asset of \$2 million for actual costs incurred, and the Company is seeking recovery of this asset in its current base rate case.

**FERC Jurisdictional Pension Costs.** Other regulatory assets include pension costs of \$3 million incurred by the Company and allocated to its FERC jurisdictional ratepayers. The Company will seek recovery of this asset in the next FERC rate proceeding.

**Rate Case Expenses.** KU incurred \$1 million in expenses related to the development and support of the 2008 Kentucky base rate case. The Kentucky Commission approved the establishment of a regulatory asset for these expenses and authorized amortization over three years beginning in March 2009.

**CMRG and KCCS Contributions.** In July 2008, KU and LG&E, along with Duke Energy Kentucky, Inc. and Kentucky Power Company, filed an application with the Kentucky Commission requesting approval to establish regulatory assets related to contributions to the CMRG for the development of technologies for reducing carbon dioxide emissions and the KCCS to study the feasibility of geologic storage of carbon dioxide. The filing companies proposed that these contributions be treated as regulatory assets to be deferred until recovery is provided in the next base rate case of each company, at which time the regulatory assets will be amortized over the life of each project: four years with respect to the KCCS and ten years with respect to the CMRG. KU and LG&E jointly agreed to provide less than \$2 million over two years to the KCCS and up to \$2 million over ten years to the CMRG. In October 2008, an Order approving the establishment of the requested regulatory assets was received and KU is seeking rate recovery in the Company's 2010 Kentucky base rate case.

**Deferred Storm Costs.** Based on an Order from the Kentucky Commission in June 2004, KU reclassified from maintenance expense to a regulatory asset, \$4 million related to costs not reimbursed from the 2003 ice storm. These costs were amortized through June 2009. KU earned a return of these amortized costs, which were included in jurisdictional operating expenses.

**Pension and Postretirement Benefits.** KU accounts for pension and postretirement benefits in accordance with the compensation – retirement benefits guidance of the FASB ASC. This guidance

requires employers to recognize the over-funded or under-funded status of a defined benefit pension and postretirement plan as an asset or liability in the balance sheet and to recognize through other comprehensive income the changes in the funded status in the year in which the changes occur. Under the regulated operations guidance of the FASB ASC, KU can defer recoverable costs that would otherwise be charged to expense or equity by non-regulated entities. Current rate recovery in Kentucky and Virginia is based on the compensation – retirement benefits guidance of the FASB ASC. Regulators have been clear and consistent with their historical treatment of such rate recovery, therefore, the Company has recorded a regulatory asset representing the change in funded status of the pension plan that is expected to be recovered and a regulatory liability representing the change in funded status of the postretirement plan that is expected to be refunded. The regulatory asset and liability will be adjusted annually as prior service cost and actuarial gains and losses are recognized in net periodic benefit cost.

**Accumulated Cost of Removal of Utility Plant.** As of December 31, 2009 and 2008, KU has segregated the cost of removal, previously embedded in accumulated depreciation, of \$331 million and \$329 million, respectively, in accordance with FERC Order No. 631. This cost of removal component is for assets that do not have a legal ARO under the asset retirement and environmental obligations guidance of the FASB ASC. For reporting purposes in the balance sheets, KU has presented this cost of removal as a regulatory liability pursuant to the regulated operations guidance of the FASB ASC.

**Deferred Income Taxes – Net.** These regulatory assets and liabilities represent the future revenue impact from the reversal of deferred income taxes required for unamortized investment tax credits, the allowance for funds used during construction and deferred taxes provided at rates in excess of currently enacted rates.

**DSM.** KU's rates contain a DSM provision which includes a rate mechanism that provides for concurrent recovery of DSM costs and provides an incentive for implementing DSM programs. The provision allows KU to recover revenues from lost sales associated with the DSM programs based on program plan engineering estimates and post-implementation evaluations.

In July 2007, KU and LG&E filed an application with the Kentucky Commission requesting an order approving enhanced versions of the existing DSM programs along with the addition of several new cost effective programs. The total annual budget for these programs is approximately \$26 million. In March 2008, the Kentucky Commission issued an Order approving the application, with minor modifications. KU and LG&E filed revised tariffs in April 2008, under authority of this Order, which were effective in May 2008.

#### Other Regulatory Matters

**Kentucky Commission Report on Storms.** In November 2009, the Kentucky Commission issued a report following review and analysis of the effects and utility response to the September 2008 wind storm and the January 2009 ice storm, and possible utility industry preventative measures relating thereto. The report suggested a number of proposed or recommended preventative or responsive measures, including consideration of selective hardening of facilities, altered vegetation management programs, enhanced customer outage communications and similar measures. In March 2010, the Companies filed a joint response reporting on their actions with respect to such recommendations. The response indicated implementation or completion of substantially all of the recommendations, including, among other matters, on-going reviews of system hardening and vegetation management procedures, certain test or pilot programs in such areas, and fielding of enhanced operational and customer outage-related systems.

**Wind Power Agreements.** In August 2009, KU and LG&E filed a notice of intent with the Kentucky Commission indicating their intent to file an application for approval of wind power purchase contracts and cost recovery mechanisms. The contracts were executed in August 2009, and are contingent upon KU and LG&E receiving acceptable regulatory approvals. Pursuant to the proposed 20-year contracts, KU and LG&E would jointly purchase respective assigned portions of the output of two Illinois wind farms totaling an aggregate 109.5 Mw. In September 2009, the Companies filed an application and supporting testimony with the Kentucky Commission. In October 2009, the Kentucky Commission issued an Order denying the Companies' request to establish a surcharge for recovery of the costs of purchasing wind power. The Kentucky Commission stated that such recovery constitutes a general rate adjustment and is subject to the regulations of a base rate case. The Kentucky Commission Order currently provides for the request for approval of the wind power agreements to proceed independently from the request to recover the costs thereof via surcharges. In November 2009, KU and LG&E filed for rehearing of the Kentucky Commission's Order and requested that the matters of approval of the contract and recovery of the costs thereof remain the subject of the same proceeding. During December 2009, the Kentucky Commission issued data requests on this matter. In March 2010, the Companies filed a motion requesting a ruling on this matter during the second quarter of 2010. The Companies cannot currently predict the timing or outcome of this proceeding.

**Trimble County Asset Purchase and Depreciation.** KU and LG&E are currently constructing a new base-load, coal fired unit, TC2, which will be jointly owned by the Companies, together with the IMEA and the IMPA. In July 2009, the Companies notified the Kentucky Commission of the proposed sale from LG&E to KU of certain ownership interests in certain existing Trimble County generating station assets which are anticipated to provide joint or common use in support of the jointly-owned TC2 generating unit under construction at the station. The undivided ownership interests being sold are intended to provide KU an ownership interest in these common assets that is proportional to its interest in TC2 and the assets' role in supporting both TC1 and TC2. In December 2009, KU and LG&E completed the sale transaction at a price of \$48 million, representing the current net book value of the assets, multiplied by the proportional interest being sold.

In August 2009, in a separate proceeding, KU and LG&E jointly filed an application with the Kentucky Commission to approve new depreciation rates for applicable TC2-related generating, pollution control and other plant equipment and assets. The filing requests common depreciation rates for the applicable jointly-owned TC2-related assets, rather than applying differing depreciation rates in place with respect to KU's and LG&E's separately-owned base-load generating assets. During December 2009, the Kentucky Commission extended the data discovery process through January 2010 and authorized KU and LG&E on an interim basis to begin using the depreciation rates for TC2 as proposed in the application. In March 2010, the Kentucky Commission issued a final Order approving the use of the proposed depreciation rates on a permanent basis.

**TC2 CCN Application and Transmission Matters.** An application for a CCN for construction of TC2 was approved by the Kentucky Commission in November 2005. CCNs for two transmission lines associated with TC2 were issued by the Kentucky Commission in September 2005 and May 2006. All regulatory approvals and rights of way for one transmission line have been obtained.

The CCN for the remaining line has been challenged by certain property owners in Hardin County, Kentucky. In August 2006, KU and LG&E obtained a successful dismissal of the challenge at the Franklin County Circuit Court, which ruling was reversed by the Kentucky Court of Appeals in December 2007, and the proceeding reinstated. A motion for discretionary review of that reversal was filed by KU and LG&E with the Kentucky Supreme Court and was granted in April 2009. That proceeding, which seeks reinstatement of the Circuit Court dismissal of the CCN challenge, has been

fully briefed and oral argument occurred during March 2010. A ruling on the matter could occur by mid 2010.

Completion of the transmission lines are also subject to standard construction permit, environmental authorization and real property or easement acquisition procedures and certain Hardin County landowners have raised challenges to the transmission line in some of these forums as well.

During 2008, KU obtained various successful rulings at the Hardin County Circuit Court confirming its condemnation rights. In August 2008, several landowners appealed such rulings to the Kentucky Court of Appeals and received a temporary stay preventing KU from accessing their properties. In April 2009, that appellate court denied KU's motion to lift the stay and issued an Order retaining the stay until a decision on the merits of the appeal. Efforts to seek reconsideration of that ruling, or to obtain intermediate review of the ruling by the Kentucky Supreme Court, were unsuccessful, and the stay remains in effect. The underlying appeal on KU's right to condemn remains pending before the Court of Appeals and oral argument on the matter is scheduled to occur during late March 2010.

Settlement discussions with the Hardin County property owners involved in the appeals of the condemnation proceedings have been unsuccessful to date. During the fourth quarter of 2008, KU and LG&E entered into settlements with certain Meade County landowners and obtained dismissals of prior litigation they had brought challenging the same transmission line.

As a result of the aforementioned unresolved litigation delays encountered in obtaining access to certain properties in Hardin County, KU has obtained easements to allow construction of temporary transmission facilities bypassing those properties while the litigated issues are resolved. In September 2009, the Kentucky Commission issued an Order stating that a CCN was necessary for two segments of the proposed temporary facilities. In December 2009, the Kentucky Commission granted the CCNs for the relevant segments and the property owners have filed various motions to intervene, stay and appeal certain elements of the Kentucky Commission's recent orders. In January 2010, in respect of two of such proceedings, the Franklin County circuit court issued Orders denying the property owners' request for a stay of construction and upholding the prior Kentucky Commission denial of their intervenor status. In parallel with, and consistent with the relevant proceedings and their status, the Company is conducting appropriate real estate acquisition and construction activities with respect to these temporary transmission facilities.

In a separate proceeding, certain Hardin County landowners have also challenged the same transmission line in federal district court in Louisville, Kentucky. In that action, the landowners claim that the U.S. Army failed to comply with certain National Historic Preservation Act requirements relating to easements for the line through Fort Knox. KU and LG&E are cooperating with the U.S. Army in its defense in this case and in October 2009, the federal court granted the defendants' motion for summary judgment and dismissed the plaintiffs' claims. During November 2009, the petitioners filed submissions for review of the decision with the 6<sup>th</sup> Circuit Court of Appeals.

KU and LG&E are not currently able to predict the ultimate outcome and possible effects, if any, on the construction schedule relating to the transmission line approval, land acquisition and permitting proceedings.

**Utility Competition in Virginia.** The Commonwealth of Virginia passed the Virginia Electric Utility Restructuring Act in 1999. This act gave customers the ability to choose their electric supplier and capped electric rates through December 2010. KU subsequently received a legislative exemption from the customer choice requirements of this law. In April 2007, however, the Virginia General Assembly

amended the Virginia Electric Utility Restructuring Act, thereby terminating this competitive market and commencing re-regulation of utility rates. The new act ended the cap on rates at the end of 2008. Pursuant to this legislation, the Virginia Commission adopted regulations revising the rules governing utility rate increase applications. As of January 2009, a hybrid model of regulation is being applied in Virginia. Under this model, utility rates are reviewed every two years. KU's exemption from the requirements of the Virginia Electric Utility Restructuring Act in 1999, however, discharges the Company from the requirements of the new hybrid model of regulation. In lieu of submitting an annual information filing, the Company has the option of requesting a change in base rates to recover prudently incurred costs by filing a traditional base rate case. KU is also subject to other utility regulations in Virginia, including, but not limited to, the recovery of prudently incurred fuel costs through an annual fuel factor charge and the submission of integrated resource plans.

**Market-Based Rate Authority.** In July 2006, the FERC issued an Order in KU's market-based rate proceeding accepting the Company's further proposal to address certain market power issues the FERC had claimed would arise upon an exit from the MISO. In particular, the Company received permission to sell power at market-based rates at the interface of control areas in which it may be deemed to have market power, subject to a restriction that such power not be collusively re-sold back into such control areas. However, restrictions exist on sales by KU of power at market-based rates in the KU/LG&E and Big Rivers Electric Corporation control areas. In June 2007, the FERC issued Order No. 697 implementing certain reforms to market-based rate regulations, including restrictions similar to those previously in place for the Company's power sales at control area interfaces. In December 2008, the FERC issued Order No. 697-B potentially placing additional restrictions on certain power sales involving areas where market power is deemed to exist. As a condition of receiving and retaining market-based rate authority, KU must comply with applicable affiliate restrictions set forth in the FERC regulation. During September 2008, the Company submitted a regular tri-annual update filing under market-based rate regulations.

In June 2009, the FERC issued Order No. 697-C which generally clarified certain interpretations relating to power sales and purchases at control area interfaces or into control areas involving market power. In July 2009, the FERC issued an order approving the Company's September 2008 application for market-based rate authority. During July 2009, affiliates of KU completed a transaction terminating certain prior generation and power marketing activities in the Big Rivers Electric Corporation control area, which termination should ultimately allow a filing to request a determination that the Company no longer is deemed to have market power in such control area.

*KU conducts certain of its wholesale power sales activities in accordance with existing market-based rate authority principles and interpretations. Future FERC proceedings relating to Orders 697 or market-based rate authority could alter the amount of sales made at market-based versus cost-based rates. The Company's sales under market-based rate authority totaled less than \$1 million for the year ended December 31, 2009.*

**Mandatory Reliability Standards.** As a result of the EPAct 2005, certain formerly voluntary reliability standards became mandatory in June 2007, and authority was delegated to various Regional Reliability Organizations ("RROs") by the NERC, which was authorized by the FERC to enforce compliance with such standards, including promulgating new standards. Failure to comply with mandatory reliability standards can subject a registered entity to sanctions, including potential fines of up to \$1 million per day, as well as non-monetary penalties, depending upon the circumstances of the violation. KU is a member of the SERC Reliability Corporation ("SERC"), which acts as KU's RRO. During May 2008, the SERC and KU agreed to a settlement involving penalties totaling less than \$1 million related to KU's February 2008 self-report concerning possible violations of certain existing mitigation plans

relating to reliability standards. During December 2009, the SERC and KU agreed to a settlement involving penalties totaling less than \$1 million concerning a June 2008 self-report by KU relating to three other standards and an October 2008 self-report relating to an additional standard. During December 2009, KU submitted a self-report relating to an additional standard. SERC proceedings for the December 2009 self-report are in the early stages and therefore the outcome is unable to be determined. Mandatory reliability standard settlements commonly include other non-penalty elements, including compliance steps and mitigation plans. Settlements with the SERC proceed to NERC and FERC review before becoming final. While KU believes itself to be in compliance with the mandatory reliability standards, the Company cannot predict the outcome of other analyses, including on-going SERC or other reviews described above.

**Integrated Resource Planning.** Integrated resource planning (“IRP”) regulations in Kentucky require major utilities to make triennial IRP filings with the Kentucky Commission. In April 2008, KU and LG&E filed their 2008 joint IRP with the Kentucky Commission. The IRP provides historical and projected demand, resource and financial data, and other operating performance and system information. The Kentucky Commission issued a staff report and Order closing this proceeding in December 2009. Pursuant to the Virginia Commission’s December 2008 Order, KU filed its IRP in July 2009. The filing consisted of the 2008 Joint IRP filed by KU and LG&E with the Kentucky Commission along with additional data. The Virginia Commission has not established a procedural schedule for this proceeding.

**PUHCA 2005.** E.ON, KU’s ultimate parent, is a registered holding company under PUHCA 2005. E.ON, its utility subsidiaries, including KU, and certain of its non-utility subsidiaries, are subject to extensive regulation by the FERC with respect to numerous matters, including: electric utility facilities and operations, wholesale sales of power and related transactions, accounting practices, issuances and sales of securities, acquisitions and sales of utility properties, payments of dividends out of capital and surplus, financial matters and inter-system sales of non-power goods and services. KU believes that it has adequate authority, including financing authority, under existing FERC orders and regulations to conduct its business and will seek additional authorization when necessary.

**EPAct 2005.** The EPAct 2005 was enacted in August 2005. Among other matters, this comprehensive legislation contains provisions mandating improved electric reliability standards and performance; granting enhanced civil penalty authority to the FERC; providing economic and other incentives relating to transmission, pollution control and renewable generation assets; increasing funding for clean coal generation incentives; repealing the Public Utility Holding Company Act of 1935; enacting PUHCA 2005 and expanding FERC jurisdiction over public utility holding companies and related matters via the Federal Power Act and PUHCA 2005.

In February 2006, the Kentucky Commission initiated an administrative proceeding to consider the requirements of the EPAct 2005, Subtitle E Section 1252, *Smart Metering*, which concerns time-based metering and demand response, and Section 1254, *Interconnections*. EPAct 2005 requires each state regulatory authority to conduct a formal investigation and issue a decision on whether or not it is appropriate to implement certain Section 1252 standards within eighteen months after the enactment of EPAct 2005 and to commence consideration of Section 1254 standards within one year after the enactment of EPAct 2005. Following a public hearing with all Kentucky jurisdictional electric utilities, in December 2006, the Kentucky Commission issued an Order in this proceeding indicating that the EPAct 2005 Section 1252 and Section 1254 standards should not be adopted. However, all five Kentucky Commission jurisdictional utilities are required to file real-time pricing pilot programs for their large commercial and industrial customers. KU developed a real-time pricing pilot for large industrial and commercial customers and filed the details of the plan with the Kentucky Commission in April 2007. In February 2008, the Kentucky Commission issued an Order approving the real-time

pricing pilot program proposed by KU for implementation within approximately eight months, for its large commercial and industrial customers. The tariff was filed in October 2008, with an effective date of December 1, 2008. KU files annual reports on the program within 90 days of each plan year-end for the 3-year pilot period.

**Green Energy Riders.** In February 2007, KU and LG&E filed a Joint Application and Testimony for Proposed Green Energy Riders. In May 2007, a Kentucky Commission Order was issued authorizing KU to establish Small and Large Green Energy Riders, allowing customers to contribute funds to be used for the purchase of renewable energy credits. During November 2009, KU and LG&E filed an application to both continue and modify the existing Green Energy Programs and requested a Kentucky Commission Order by March 2010.

**Home Energy Assistance Program.** In July 2007, KU filed an application with the Kentucky Commission for the establishment of a Home Energy Assistance program. During September 2007, the Kentucky Commission approved the five-year program as filed, effective in October 2007. The program terminates in September 2012, and is funded through a \$0.10 per month meter charge. Effective February 6, 2009, as a result of the settlement agreement in the 2008 base rate case, the program is funded through a \$0.15 per month meter charge.

**Collection Cycle Revision.** As part of its base rate case filed on July 29, 2008, LG&E proposed to change the due date for customer bill payments from 15 days to 10 days to align its collection cycle with KU. In addition, KU proposed to include a late payment charge if payment is not received within 15 days from the bill issuance date to align with LG&E. The settlement agreement approved in the rate case in February 2009, changed the due date for customer bill payments to 12 days after bill issuance for both KU and LG&E, and permitted KU's implementation of a late payment charge if payment is not received within 15 days from the bill issuance date.

**Depreciation Study.** In December 2007, KU filed a depreciation study with the Kentucky Commission as required by a previous Order. In August 2008, the Kentucky Commission issued an Order consolidating the depreciation study with the base rate case proceeding. The approved settlement agreement in the rate case established new depreciation rates effective February 2009. KU also filed the depreciation study with the Virginia Commission which approved the implementation of the new depreciation rates effective February 2009. Approval by the Virginia Commission does not preclude the rates from being raised as an issue by any party in KU's current base rate case in Virginia.

**Brownfield Development Rider Tariff.** In March 2008, KU received Kentucky Commission approval for a Brownfield Development Rider, which offers a discounted rate to electric customers who meet certain usage and location requirements, including taking new service at a brownfield site, as certified by the appropriate Kentucky state agency. The rider permits special contracts with such customers which provide for a series of declining partial rate discounts over an initial five-year period of a longer service arrangement. The tariff is intended to promote local economic redevelopment and efficient usage of utility resources by aiding potential reuse of vacant brownfield sites.

**Interconnection and Net Metering Guidelines.** In May 2008, the Kentucky Commission on its own motion initiated a proceeding to establish interconnection and net metering guidelines in accordance with amendments to existing statutory requirements for net metering of electricity. The jurisdictional electric utilities and intervenors in this case presented proposed interconnection guidelines to the Kentucky Commission in October 2008. In a January 2009 Order, the Kentucky Commission issued the Interconnection and Net Metering Guidelines – Kentucky that were developed by all parties to the proceeding. KU does not expect any financial or other impact as a result of this Order. In April 2009,



KU filed revised net metering tariffs and application forms pursuant to the Kentucky Commission's Order. The Kentucky Commission issued an Order in April 2009, which suspended for five months all net metering tariffs filed by the jurisdictional electric utilities. This suspension was intended to allow sufficient time for review of the filed tariffs by the Kentucky Commission Staff and intervening parties. In June 2009, the Kentucky Commission Staff held an informal conference with the parties to discuss issues related to the net metering tariffs filed by KU. Following this conference, the intervenors and KU resolved all issues and KU filed revised net metering tariffs with the Kentucky Commission. In August 2009, the Kentucky Commission issued an Order approving the revised tariffs.

**EISA 2007 Standards.** In November 2008, the Kentucky Commission initiated an administrative proceeding to consider new standards as a result of the Energy Independence and Security Act of 2007 ("EISA 2007"), part of which amends the Public Utility Regulatory Policies Act of 1978 ("PURPA"). There are four new PURPA standards and one non-PURPA standard applicable to electric utilities. The proceeding also considers two new PURPA standards applicable to natural gas utilities. EISA 2007 requires state regulatory commissions and nonregulated utilities to begin consideration of the rate design and smart grid investments no later than December 19, 2008, and to complete the consideration by December 19, 2009. The Kentucky Commission established a procedural schedule that allowed for data discovery and testimony through July 2009. A public hearing has not been scheduled in this matter. In October 2009, the Kentucky Commission held an informal conference for the purpose of discussing issues related to the standard regarding the consideration of Smart Grid investments.

### Note 3 - Financial Instruments

The cost and estimated fair values of KU's non-trading financial instruments as of December 31 follow:

(in millions)	<u>2009</u>		<u>2008</u>	
	<u>Carrying Value</u>	<u>Fair Value</u>	<u>Carrying Value</u>	<u>Fair Value</u>
Long-term debt (including current portion of \$228 million)	\$ 351	\$ 351	\$ 351	\$ 349
Long-term debt from affiliate (including current portion of \$33 million)	\$ 1,331	\$ 1,401	\$1,181	\$1,117

The long-term debt valuations reflect prices quoted by dealers. The fair value of the long-term debt from affiliate is determined using an internal valuation model that discounts the future cash flows of each loan at current market rates. The current market values are determined based on quotes from investment banks that are actively involved in capital markets for utilities and factor in KU's credit ratings and default risk. The fair values of cash and cash equivalents, accounts receivable, cash surrender value of key man life insurance, accounts payable and notes payable are substantially the same as their carrying values.

KU is subject to the risk of fluctuating interest rates in the normal course of business. The Company's policies allow the interest rate risk to be managed through the use of fixed rate debt, floating rate debt and interest rate swaps. At December 31, 2009, a 100 basis point change in the benchmark rate on KU's variable rate debt would impact pre-tax interest expense by \$4 million annually. Although the Company's policies allow for the use of interest rate swaps, as of December 31, 2008 and 2009, KU had no interest rate swaps outstanding.

The Company is subject to interest rate and commodity price risk related to on-going business operations. It currently manages these risks using derivative financial instruments including swaps and forward contracts.

KU has classified the applicable financial assets and liabilities that are accounted for at fair value into the three levels of the fair value hierarchy, as defined by the fair value measurements and disclosures guidance of the FASB ASC, as follows:

- Level 1 - Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 - Include other inputs that are directly or indirectly observable in the marketplace.
- Level 3 - Unobservable inputs which are supported by little or no market activity.

**Energy Trading and Risk Management Activities.** KU conducts energy trading and risk management activities to maximize the value of power sales from physical assets it owns. Energy trading activities are principally forward financial transactions to manage price risk and are accounted for as non-hedging derivatives on a mark-to-market basis in accordance with the derivatives and hedging guidance of the FASB ASC.

Energy trading and risk management contracts are valued using prices based on active trades from Intercontinental Exchange Inc. In the absence of a traded price, midpoints of the best bids and offers are the primary determinants of valuation. When sufficient trading activity is unavailable, other inputs include prices quoted by brokers or observable inputs other than quoted prices, such as one-sided bids or offers as of the balance sheet date. Using these valuation methodologies, these contracts are considered level 2 based on measurement criteria in the fair value measurements and disclosures guidance of the FASB ASC. Quotes are verified quarterly using an independent pricing source of actual transactions. Quotes for combined off-peak and weekend timeframes are allocated between the two timeframes based on their historically proportionate ratios to the integrated cost. No other adjustments are made to the forward prices. No changes to valuation techniques for energy trading and risk management activities occurred during 2009, 2008 or 2007. Changes in market pricing, interest rate and volatility assumptions were made during both years.

The Company maintains credit policies intended to minimize credit risk in wholesale marketing and trading activities by assessing the creditworthiness of potential counterparties prior to entering into transactions with them and continuing to evaluate their creditworthiness once transactions have been initiated. To further mitigate credit risk, KU seeks to enter into netting agreements or require cash deposits, letters of credit and parental company guarantees as security from counterparties. The Company uses S&P, Moody's and definitive qualitative and quantitative data to assess the financial strength of counterparties on an on-going basis. If no external rating exists, KU assigns an internally generated rating for which it sets appropriate risk parameters. As risk management contracts are valued based on changes in market prices of the related commodities, credit exposures are revalued and monitored on a daily basis. At December 31, 2009, 100% of the trading and risk management commitments were with counterparties rated BBB-/Baa3 equivalent or better. The Company has reserved against counterparty credit risk based on the counterparty's credit rating and applying historical default rates within varying credit ratings over time provided by S&P or Moody's. At December 31, 2009 and 2008, credit reserves related to the energy trading and risk management contracts were less than \$1 million.

The net volume of electricity based financial derivatives outstanding at December 31, 2009 and 2008, was 315,600 Mwhts and 146,000 Mwhts, respectively. All the volume outstanding at December 31, 2009 will settle in 2010.

The following table sets forth by level within the fair value hierarchy, KU's financial assets and liabilities that were accounted for at fair value on a recurring basis as of December 31, 2008. Cash collateral related to the energy trading and risk management contracts was less than \$1 million at December 31, 2009 and 2008. Cash collateral related to the energy trading and risk management contracts is categorized as other accounts receivable and is a level 1 measurement based on the funds being held in liquid accounts. Energy trading and risk management contracts are considered level 2 based on measurement criteria in the fair value measurements and disclosures guidance of the FASB ASC. Financial assets as of December 31, 2009 and financial liabilities as of December 31, 2009 and 2008, arising from energy trading and risk management contracts accounted for at fair value total less than \$1 million and use level 2 measurements. There are no level 3 measurements for the periods ending December 31, 2009 and 2008.

December 31, 2008

	<u>Level 1</u>	<u>Level 2</u>	<u>Total</u>
Financial Assets:			
Energy trading and risk management contracts	\$ -	\$ 1	\$ 1
Total Financial Assets	<u>\$ -</u>	<u>\$ 1</u>	<u>\$ 1</u>

The Company does not net collateral against derivative instruments.

Certain of the Company's derivative instruments contain provisions that require the Company to provide immediate and on-going collateralization on derivative instruments in net liability positions based upon the Company's credit ratings from each of the major credit rating agencies. At December 31, 2009, there are no energy trading and risk management contracts with credit risk related contingent features that are in a liability position, and no collateral posted in the normal course of business. At December 31, 2009, a one notch downgrade of the Company's credit rating would have no effect on the energy trading and risk management contracts or collateral required as a result of these contracts.

The table below shows the fair value and balance sheet location of derivatives not designated as hedging instruments as of December 31, 2008:

December 31, 2008

Energy trading and risk management contracts (current)	Other current assets	<u>\$ 1</u>	Other current liabilities	<u>\$ -</u>
Total		<u>\$ 1</u>		<u>\$ -</u>

Financial assets and liabilities as of December 31, 2009 arising from energy trading and risk management contracts accounted for at fair value total less than \$1 million.

KU manages the price risk of its estimated future excess economic generation capacity using market-traded forward financial contracts. Hedge accounting treatment has not been elected for these transactions, and therefore gains and losses are shown in the statements of income.

The following tables present the effect of derivatives not designated as hedging instruments on income for the years ended December 31, 2009 and 2008:

(in millions) <u>December 31, 2009</u>	<u>Location of Gain (Loss) Recognized in Income on Derivatives</u>	<u>Amount of Gain (Loss) Recognized in Income on Derivatives</u>
Energy trading and risk management contracts (unrealized)	Electric revenues	<u>\$ (1)</u>
Total		<u>\$ (1)</u>
 <u>December 31, 2008</u>		
Energy trading and risk management contracts (unrealized)	Electric revenues	<u>\$ 1</u>
Total		<u>\$ 1</u>

Unrealized gains and losses were less than \$1 million for the year ended December 31, 2007. Net realized gains and losses were less than \$1 million for the years ended December 31, 2009, 2008, and 2007.

#### **Note 4 - Concentrations of Credit and Other Risk**

Credit risk represents the accounting loss that would be recognized at the reporting date if counterparties failed to perform as contracted. Concentrations of credit risk (whether on- or off-balance sheet) relate to groups of customers or counterparties that have similar economic or industry characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions.

KU's customer receivables and revenues arise from deliveries of electricity to approximately 515,000 customers in over 600 communities and adjacent suburban and rural areas in 77 counties in central, southeastern and western Kentucky, to approximately 30,000 customers in 5 counties in southwestern Virginia and 5 customers in Tennessee. For the years ended December 31, 2009, 2008 and 2007, 100% of total revenue was derived from electric operations. During 2009, the Company's 10 largest customers accounted for less than 15% of electric volumes.

Effective August 4, 2009, the Company and its employees represented by the IBEW Local 2100 entered into a three-year collective bargaining agreement. The agreement provides for negotiated increases or changes to wages, benefits or other provisions and for annual wage re-openers. KU and employees represented by the USWA Local 9447-01 entered into a three-year collective bargaining agreement in August 2008. This agreement provides for negotiated increases or changes to wages, benefits or other provisions and for annual wage re-openers. The employees represented by these two bargaining units comprise approximately 15% of the Company's workforce at December 31, 2009.

## Note 5 - Pension and Other Postretirement Benefit Plans

KU employees benefit from both funded and unfunded non-contributory defined benefit pension plans and other postretirement benefit plans that together cover employees hired by December 31, 2005. Employees hired after this date participate in the Retirement Income Account (“RIA”), a defined contribution plan. The Company makes an annual lump sum contribution to the RIA, based on years of service and a percentage of covered compensation. The health care plans are contributory with participants’ contributions adjusted annually. The Company uses December 31 as the measurement date for its plans.

**Obligations and Funded Status.** The following tables provide a reconciliation of the changes in the defined benefit plans’ obligations and the fair value of assets for the two-year period ending December 31, 2009, and the funded status for the plans as of December 31:

(in millions)	Pension Benefits		Other Postretirement Benefits	
	2009	2008	2009	2008
<b>Change in benefit obligation</b>				
Benefit obligation at beginning of year	\$ 306	\$ 284	\$ 75	\$ 76
Service cost	6	5	2	1
Interest cost	18	18	4	5
Benefits paid, net of retiree contributions	(18)	(18)	(5)	(3)
Actuarial (gain)/loss and other	4	17	4	(4)
Benefit obligation at end of year	<u>\$ 316</u>	<u>\$ 306</u>	<u>\$ 80</u>	<u>\$ 75</u>
<b>Change in plan assets</b>				
Fair value of plan assets at beginning of year	\$ 183	\$ 264	\$ 12	\$ 13
Actual return on plan assets	41	(61)	3	(3)
Employer contributions	13	-	7	5
Benefits paid, net of retiree contributions	(18)	(18)	(5)	(3)
Administrative expenses and other	-	(2)	-	-
Fair value of plan assets at end of year	<u>\$ 219</u>	<u>\$ 183</u>	<u>\$ 17</u>	<u>\$ 12</u>
<b>Funded status at end of year</b>	<u>\$ (97)</u>	<u>\$ (123)</u>	<u>\$ (63)</u>	<u>\$ (63)</u>

**Amounts Recognized in Statement of Financial Position.** The following tables provide the amounts recognized in the balance sheets and information for plans with benefit obligations in excess of plan assets as of December 31:

(in millions)	Pension Benefits		Other Postretirement Benefits	
	2009	2008	2009	2008
Regulatory assets	\$ 105	\$ 137	\$ -	\$ -
Regulatory liabilities	-	-	(9)	(10)
Accrued benefit liability (non-current)	(97)	(123)	(63)	(63)

Amounts recognized in regulatory assets and liabilities consist of:

(in millions)	Pension Benefits		Other Postretirement Benefits	
	2009	2008	2009	2008
	Transition obligation	\$ -	\$ -	\$ 3
Prior service cost	5	5	2	2
Accumulated (gain)/loss	100	132	(14)	(16)
Total regulatory assets (liabilities)	<u>\$ 105</u>	<u>\$ 137</u>	<u>\$ (9)</u>	<u>\$ (10)</u>

Additional year-end information for plans with accumulated benefit obligations in excess of plan assets:

(in millions)	Pension Benefits		Other Postretirement Benefits	
	2009	2008	2009	2008
	Benefit obligation	\$ 316	\$ 306	\$ 80
Accumulated benefit obligation	268	261	-	-
Fair value of plan assets	219	183	17	12

For discussion of the pension and postretirement regulatory assets, see Note 2, Rates and Regulatory Matters.

The amounts recognized in regulatory assets and liabilities for the years ended December 31, are composed of the following:

(in millions)	Pension Benefits		Other Postretirement Benefits	
	2009	2008	2009	2008
	Prior service cost arising during the period	\$ -	\$ -	\$ -
Net loss/(gain) arising during the period	(22)	101	2	-
Amortization of prior service (cost)/credit	(1)	(1)	-	(1)
Amortization of transitional (obligation)/asset	-	-	(1)	(1)
Amortization of gain/(loss)	(9)	-	-	-
Total amounts recognized in regulatory assets & liabilities	<u>\$ (32)</u>	<u>\$ 100</u>	<u>\$ 1</u>	<u>\$ (1)</u>

**Components of Net Periodic Benefit Cost.** The following tables provide the components of net periodic benefit cost for pension and other postretirement benefit plans. The tables include the costs associated with both KU employees and E.ON U.S. Services' employees, who provide services to the utility. The E.ON U.S. Services' costs that are allocated to KU are approximately 49%, 46% and 45% of E.ON U.S. Services' total cost for 2009, 2008 and 2007, respectively.

(in millions)

**Pension Benefits**

	E.ON U.S.			E.ON U.S.			E.ON U.S.		
	KU	Services	Total	KU	Services	Total	KU	Services	Total
		Allocation	KU		Allocation	KU		Allocation	KU
2009	to KU	2009	2008	to KU	2008	2007	to KU	2007	
Service cost	\$ 6	\$ 5	\$ 11	\$ 6	\$ 4	\$ 10	\$ 6	\$ 4	\$ 10
Interest cost	18	7	25	18	6	24	17	5	22
Expected return on plan assets	(15)	(4)	(19)	(21)	(5)	(26)	(21)	(5)	(26)
Amortization of prior service costs	1	1	2	1	1	2	1	1	2
Amortization of actuarial loss	9	2	11	-	-	-	2	1	3
Benefit cost at end of year	<u>\$ 19</u>	<u>\$ 11</u>	<u>\$ 30</u>	<u>\$ 4</u>	<u>\$ 6</u>	<u>\$ 10</u>	<u>\$ 5</u>	<u>\$ 6</u>	<u>\$ 11</u>

(in millions)

**Other Postretirement Benefits**

	E.ON U.S.			E.ON U.S.			E.ON U.S.		
	KU	Services	Total	KU	Services	Total	KU	Services	Total
		Allocation	KU		Allocation	KU		Allocation	KU
2009	to KU	2009	2008	to KU	2008	2007	to KU	2007	
Service cost	\$ 1	\$ 1	\$ 2	\$ 1	\$ 1	\$ 2	\$ 1	\$ 1	\$ 2
Interest cost	5	-	5	5	-	5	5	-	5
Expected return on plan assets	(1)	-	(1)	(1)	-	(1)	(1)	-	(1)
Amortization of transitional obligation	1	-	1	1	-	1	1	-	1
Benefit cost at end of year	<u>\$ 6</u>	<u>\$ 1</u>	<u>\$ 7</u>	<u>\$ 6</u>	<u>\$ 1</u>	<u>\$ 7</u>	<u>\$ 6</u>	<u>\$ 1</u>	<u>\$ 7</u>

The estimated amounts that will be amortized from regulatory assets and liabilities into net periodic benefit cost in 2010 are shown in the following table:

(in millions)	<u>Pension Benefits</u>	<u>Other Postretirement Benefits</u>
Regulatory assets/liabilities:		
Net actuarial loss	\$ 6	\$ -
Prior service cost	1	1
Transition obligation	-	1
	<u>7</u>	<u>2</u>
Total regulatory assets/liabilities amortized during 2010	<u>\$ 7</u>	<u>\$ 2</u>

The assumptions used in the measurement of KU's pension benefit obligation are shown in the following table:

	<u>2009</u>	<u>2008</u>
Weighted-average assumptions as of December 31:		
Discount rate	6.13%	6.25%
Rate of compensation increase	5.25%	5.25%

The discount rates were determined by the December 28, 2009, Mercer Pension Discount Yield Curve. These discount rates were then lowered by 8 basis points for the average change in 4 bond indices, Citigroup High Grade Credit Index AAA/AA 10+ years, Barclays Capital US Long Credit AA, Merrill Lynch US Corporate AA-AAA rated 10+ years and Merrill Lynch US Corporate AA rated 15+ years, for the period from December 28, 2009 to December 31, 2009.

The assumptions used in the measurement of KU's net periodic benefit cost are shown in the following table:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Discount rate	6.25%	6.66%	5.96%
Expected long-term return on plan assets	8.25%	8.25%	8.25%
Rate of compensation increase	5.25%	5.25%	5.25%

To develop the expected long-term rate of return on assets assumption, KU considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the target asset allocation to develop the expected long-term rate of return on assets assumption for the portfolio.

The following describes the effects on pension benefits by changing the major actuarial assumptions discussed above:

- A 1% change in the assumed discount rate could have an approximate \$34 million positive or negative impact to the 2009 accumulated benefit obligation and an approximate \$45 million positive or negative impact to the 2009 projected benefit obligation.



- A 25 basis point change in the expected rate of return on assets would have resulted in less than a \$1 million positive or negative impact on 2009 pension expense.

**Assumed Health Care Cost Trend Rates.** For measurement purposes, an 8% annual increase in the per capita cost of covered health care benefits was assumed for 2009. The rate was assumed to decrease gradually to 4.5% by 2029 and remain at that level thereafter.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 1% change in assumed health care cost trend rates would have resulted in an increase or decrease of less than \$1 million on the 2009 total of service and interest costs components and an increase or decrease of \$4 million in year-end 2009 postretirement benefit obligations.

**Expected Future Benefit Payments and Medicare Subsidy Receipts.** The following list provides the amount of expected future benefit payments, which reflect expected future service and the estimated gross amount of Medicare subsidy receipts:

(in millions)	Pension <u>Benefits</u>	Other Postretirement <u>Benefits</u>	Medicare Subsidy <u>Receipts</u>
2010	\$ 17	\$ 6	\$ 1
2011	17	6	-
2012	17	6	1
2013	17	6	-
2014	17	7	1
2015-19	97	37	3

**Plan Assets.** The following table shows the plans' weighted-average asset allocation by asset category at December 31:

<u>Pension Plans</u>	<u>Target Range</u>	<u>2009</u>	<u>2008</u>
Equity securities	45% - 75%	59%	55%
Debt securities	30% - 50%	40	43
Other	0% - 10%	1	2
Totals		<u>100%</u>	<u>100%</u>

The investment policy of the pension plans was developed in conjunction with financial consultants, investment advisors and legal counsel. The goal of the investment policy is to preserve the capital of the fund and maximize investment earnings. The return objective is to exceed the benchmark return for the policy index comprised of the following: Russell 3000 Index, MSCI-EAFE Index, Barclays Capital Aggregate and Barclays Capital U.S. Long Government/Credit Bond Index in proportions equal to the targeted asset allocation.

Evaluation of performance focuses on a long-term investment time horizon of at least three to five years or a complete market cycle. The assets of the pension plans are broadly diversified within different asset classes (equities, fixed income securities and cash equivalents).

To minimize the risk of large losses in a single asset class, no more than 5% of the portfolio will be invested in the securities of any one issuer with the exclusion of the U.S. government and its agencies. The equity portion of the fund is diversified among the market's various subsections to diversify risk, maximize returns and avoid undue exposure to any single economic sector, industry group or individual security. The equity subsectors include, but are not limited to, growth, value, small capitalization and international.

In addition, the overall fixed income portfolio may have an average weighted duration, or interest rate sensitivity which is within +/- 20% of the duration of the overall fixed income benchmark. Foreign bonds in the aggregate shall not exceed 10% of the total fund. The portfolio may include a limited investment of up to 20% in below investment grade securities provided that the overall average portfolio quality remains "AA" or better. The below investment grade securities include, but are not limited to, medium-term notes, corporate debt, non-dollar and emerging market debt and asset backed securities. The cash investments should be in securities that are either short maturities (not to exceed 180 days) or readily marketable with modest risk.

Derivative securities are permitted only to improve the portfolio's risk/return profile, to modify the portfolio's duration or to reduce transaction costs and must be used in conjunction with underlying physical assets in the portfolio. Derivative securities that involve speculation, leverage, interest rate anticipation, or any undue risk whatsoever are not deemed appropriate investments.

The investment objective for the postretirement benefit plan is to provide current income consistent with stability of principal and liquidity while maintaining a stable net asset value of \$1.00 per share. The postretirement funds are invested in a prime cash money market fund that invests primarily in a portfolio of short-term, high-quality fixed income securities issued by banks, corporations and the U.S. government.

KU has classified plan assets that are accounted for at fair value into the three levels of the fair value hierarchy, as defined by the fair value measurements and disclosures guidance of the FASB ASC. See Note 3 of the Notes to Financial Statements.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

A description of the valuation methodologies used to measure plan assets at fair value is provided below:

*Money Market Fund:* These investments are public investment vehicles valued using \$1 for the net asset value. The money market funds are classified within level 2 of the valuation hierarchy.

*Common/Collective Trusts:* Valued based on the beginning of year value of the plan's interests in the trust plus actual contributions and allocated investment income (loss) less actual distributions and allocated administrative expenses. Quoted market prices are used to value investments in the trust, with the exception of the Group Annuity Contract ("GAC"). The fair value of certain other investments for which quoted market prices are not available are valued based on yields currently available on comparable securities of issuers with similar credit ratings. The common/collective trusts are classified within level 2 of the valuation hierarchy.

The preceding methods described may produce a fair value that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date. There were no changes in the plan's valuation methodologies during 2009.

The following table sets forth, by level within the fair value hierarchy, the plan's assets at fair value as of December 31, 2009:

(millions)	<u>Level 2</u>
Money Market Fund	\$ 2
Common/Collective Trusts	<u>186</u>
Total investments at fair value	<u>\$ 188</u>

There are no assets categorized as level 1 or level 3.

The GAC is an immediate participation guarantee contract. In accordance with the plan accounting guidance of the FASB ASC, the cost incurred to purchase the GAC prior to March 20, 1992, is permitted to be carried at contract value, since it is a contract with an insurance company and therefore is excluded from the table above. The cost incurred to fund the GAC after March 20, 1992, is carried at contract value in accordance with the plan accounting guidance of the FASB ASC, since it is a contract that incorporates mortality and morbidity risk. Contract value represents cost plus interest income less distributions for benefits and administrative expenses.

**Contributions.** KU made a discretionary contribution to the pension plan of \$13 million in April 2009 and \$13 million in January 2007. The Company also made contributions to other postretirement benefit plans of \$7 million, \$5 million and \$6 million in 2009, 2008 and 2007, respectively. The amount of future contributions to the pension plan will depend upon the actual return on plan assets and other factors, but the Company funds its pension obligations in a manner consistent with the Pension Protection Act of 2006. In January 2010, KU made a discretionary contribution to the pension plan of \$13 million and anticipates making voluntary contributions to fund Voluntary Employee Beneficiary Association trusts to match the annual postretirement expense and funding the 401(h) plan up to the maximum amount allowed by law.

**Pension Legislation.** The Pension Protection Act of 2006 was enacted in August 2006. New rules regarding funding of defined benefit plans are generally effective for plan years beginning in 2008. Among other matters, this comprehensive legislation contains provisions applicable to defined benefit plans which generally (i) mandate full funding of current liabilities within seven years; (ii) increase tax-deduction levels regarding contributions; (iii) revise certain actuarial assumptions, such as mortality tables and discount rates; and (iv) raise federal insurance premiums and other fees for under-funded and distressed plans. The legislation also contains a number of provisions relating to defined-contribution plans and qualified and non-qualified executive pension plans and other matters. The Company's plan met the minimum funding requirements as defined by the Pension Protection Act of 2006 for years ended December 31, 2009 and 2008.

**Thrift Savings Plans.** KU has a thrift savings plan under section 401(k) of the Internal Revenue Code. Under the plan, eligible employees may defer and contribute to the plan a portion of current compensation in order to provide future retirement benefits. KU makes contributions to the plan by matching a portion of the employee contributions. The costs of this matching were \$3 million in 2009 and 2008, and \$2 million in 2007.

KU also makes contributions to retirement income accounts within the thrift savings plans for certain employees not covered by noncontributory defined benefit pension plans. These employees consist mainly of those hired after December 31, 2005. The Company makes these contributions based on years of service and the employees' wage and salary levels, and it makes them in addition to the matching contributions discussed above. The amounts contributed by the Company under this arrangement equaled less than \$1 million in 2009, 2008 and 2007.

#### **Note 6 - Income Taxes**

A United States consolidated income tax return is filed by E.ON U.S.'s direct parent, E.ON US Investments Corp., for each tax period. Each subsidiary of the consolidated tax group, including KU, calculates its separate income tax for each period. The resulting separate-return tax cost or benefit is paid to or received from the parent company or its designee. The Company also files income tax returns in various state jurisdictions. While 2006 and later years are open under the federal statute of limitations, Revenue Agent Reports for 2006-2007 have been received from the IRS, effectively closing these years to additional audit adjustments. Adjustments to these tax years were previously recorded in the financial statements. Tax years 2007 and 2008 were examined under an IRS pilot program named "Compliance Assurance Process" ("CAP"). This program accelerates the IRS's review to begin during the year applicable to the return and ends 90 days after the return is filed. KU had no adjustments for the 2007 federal return. Areas remaining under examination for 2008 include bonus depreciation and the Company's application for a change in repair deductions. No net material adverse impact is expected from these remaining areas.

Additions and reductions of uncertain tax positions during 2009, 2008 and 2007 were less than \$1 million. Possible amounts of uncertain tax positions for KU that may decrease within the next 12 months total less than \$1 million and are based on the expiration of the audit periods as defined in the statutes. If recognized, the less than \$1 million of unrecognized tax benefits would reduce the effective income tax rate.

The amount KU recognized as interest expense and interest accrued related to unrecognized tax benefits was less than \$1 million as of December 31, 2009, 2008 and 2007. The interest expense and interest accrued is based on IRS and Kentucky Department of Revenue large corporate interest rates for underpayment of taxes. At the date of adoption, the Company accrued less than \$1 million in interest expense on uncertain tax positions. KU records the interest as interest expense and penalties as operating expenses in the income statement and accrued expenses in the balance sheets, on a pre-tax basis. No penalties were accrued by the Company through December 31, 2009.

Components of income tax expense are shown in the table below:

(in millions)	<u>2009</u>	<u>2008</u>	<u>2007</u>
Current - federal	\$ (5)	\$ 46	\$ 28
- state	1	10	13
Deferred - federal – net	43	(10)	(5)
- state – net	7	(3)	(1)
Investment tax credit – deferred	21	25	43
Amortization of investment tax credit	-	-	(1)
Total income tax expense	<u>\$ 67</u>	<u>\$ 68</u>	<u>\$ 77</u>

Deferred federal and state income tax expense increased in 2009, compared to 2008, due primarily to temporary differences related to storm costs and depreciation. The temporary differences also resulted in an offsetting decrease to current federal and state taxes in 2009. Current federal income tax expense increased in 2008, compared to 2007, and investment tax credit – deferred decreased primarily due to claiming \$18 million less in investment tax credits in 2008. Current state income tax decreased due to coal credits claimed in 2008. Deferred federal income tax expense decreased in 2008 primarily due to adjusting prior year estimates to actual based on the filed tax return.

In June 2006, KU and LG&E filed a joint application with the U.S. Department of Energy (“DOE”) requesting certification to be eligible for investment tax credits applicable to the construction of TC2. In November 2006, the DOE and the IRS announced that KU and LG&E were selected to receive the tax credit. A final IRS certification required to obtain the investment tax credit was received in August 2007. In September 2007, KU received an Order from the Kentucky Commission approving the accounting of the investment tax credit. KU’s portion of the TC2 tax credit will be approximately \$101 million over the construction period and will be amortized to income over the life of the related property beginning when the facility is placed in service. Based on eligible construction expenditures incurred, KU recorded investment tax credits of \$21 million, \$25 million and \$43 million in 2009, 2008 and 2007, respectively, decreasing current federal income taxes. The amount claimed through 2009 is all that KU is allowed to claim. KU has reached the maximum credit of \$101 million. In addition, a full depreciation basis adjustment is required for the amount of the credit. The income tax expense impact from amortizing these credits will begin when the facility is placed in service.

In March 2008, certain environmental and preservation groups filed suit in federal court in North Carolina against the DOE and IRS claiming the investment tax credit program was in violation of certain environmental laws and demanded relief, including suspension or termination of the program. During 2008 and 2009, the plaintiffs submitted amended complaints alleging additional claims for relief. In October 2009, the plaintiffs filed a motion for a preliminary injunction seeking temporary implementation of certain elements of the requested relief. The Company is not currently a party to this proceeding and is not able to predict the ultimate outcome of this matter.

Components of net deferred tax liabilities included in the balance sheets are shown below:

(in millions)	<u>2009</u>	<u>2008</u>
Deferred tax liabilities:		
Depreciation and other plant-related items	\$ 303	\$ 284
Regulatory assets and other	<u>69</u>	<u>40</u>
Total deferred tax liabilities	<u>372</u>	<u>324</u>
Deferred tax assets:		
Income taxes due to customers	4	6
Pensions and related benefits	17	19
Liabilities and other	<u>18</u>	<u>22</u>
Total deferred tax assets	<u>39</u>	<u>47</u>
Net deferred income tax liability	<u>\$ 333</u>	<u>\$ 277</u>
Balance sheet classification		
Current assets	\$ (3)	\$ (2)
Non-current liabilities	<u>336</u>	<u>279</u>
Net deferred income tax liability	<u>\$ 333</u>	<u>\$ 277</u>

The Company expects to have adequate levels of taxable income to realize its recorded deferred tax assets.

A reconciliation of differences between the statutory U.S. federal income tax rate and KU's effective income tax rate follows:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Statutory federal income tax rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	2.7	2.6	3.4
Reduction of income tax reserve	-	(0.2)	(0.4)
Qualified production activities deduction	(0.3)	(1.1)	(1.2)
Dividends received deduction related to EEI investment	(1.5)	(4.2)	(2.9)
Reversal of excess deferred taxes	(0.9)	(0.6)	(0.8)
Other differences	<u>(1.5)</u>	<u>(1.4)</u>	<u>(1.5)</u>
Effective income tax rate	<u>33.5%</u>	<u>30.1%</u>	<u>31.6%</u>

The effective income tax rate increased from 2008 to 2009 primarily due to a \$15 million decrease in 2009 dividends received from Electric Energy Inc., reducing the dividends received deduction. The effective income tax rate decreased from 2007 to 2008 primarily due to increased dividends from its investment in EEI.

## Note 7 - Long-Term Debt

As of December 31, 2009 and 2008, long-term debt and the current portion of long-term debt consist primarily of pollution control bonds and long-term loans from affiliated companies as summarized below.

(in millions)	<u>Stated Interest Rates</u>	<u>Maturities</u>	<u>Principal Amounts</u>
Outstanding at December 31, 2009:			
Noncurrent portion	Variable – 7.035%	2011-2037	\$1,421
Current portion	Variable – 4.240%	2010-2034	\$ 261
Outstanding at December 31, 2008:			
Noncurrent portion	Variable – 7.035%	2010-2037	\$1,304
Current portion	Variable	2023-2034	\$ 228

Long-term debt includes \$228 million of pollution control bonds that are classified as current portion because these bonds are subject to tender for purchase at the option of the holder and to mandatory tender for purchase upon the occurrence of certain events. These bonds include Carroll County 2002 Series A and B, 2004 Series A, 2006 Series B and 2008 Series A; Muhlenberg County 2002 Series A; and Mercer County 2000 Series A and 2002 Series A. Maturity dates for these bonds range from 2023 to 2034. The average annualized interest rate for these bonds during 2009, 2008 and 2007, was 0.61%, 1.75% and 3.72%, respectively.

Pollution control bonds are obligations issued in connection with tax-exempt pollution control revenue bonds issued by various governmental entities, principally counties in Kentucky. A loan agreement obligates the Company to make debt service payments to the county that equate to the debt service due from the county on the related pollution control revenue bonds. The loan agreement is an unsecured obligation of the Company. Proceeds from bond issuances for environmental equipment (primarily related to the installation of FGDs) were held in trust pending expenditure for qualifying assets. At December 31, 2009, KU had no bond proceeds in trust included in restricted cash on the balance sheet. At December 31, 2008, the Company had \$9 million of bond proceeds in trust included in restricted cash in the balance sheets.

Several of the pollution control bonds are insured by monoline bond insurers whose ratings have been reduced due to exposures relating to insurance of sub-prime mortgages. At December 31, 2009, the Company had an aggregate \$351 million of outstanding pollution control indebtedness, of which \$96 million is in the form of insured auction rate securities wherein interest rates are reset every 35 days via an auction process. Beginning in late 2007, the interest rates on these insured bonds began to increase due to investor concerns about the creditworthiness of the bond insurers. During 2008, interest rates increased, and the Company experienced “failed auctions” when there were insufficient bids for the bonds. When a failed auction occurs, the interest rate is set pursuant to a formula stipulated in the indenture. During 2009, 2008 and 2007, the average rate on the auction rate bonds was 0.44%, 4.50% and 3.96%, respectively. The instruments governing these auction rate bonds permit KU to convert the bonds to other interest rate modes, such as various short-term variable rates, long-term fixed rates or intermediate-term fixed rates that are reset infrequently. In June 2009, S&P downgraded the credit rating of Ambac from “A” to “BBB”. As a result, S&P downgraded the rating on certain bonds in June 2009. The S&P rating of these bonds is now based on the rating of the Company rather than the rating of Ambac since the Company’s rating is higher. The following table presents the bonds downgraded:

(\$ in millions) <u>Tax Exempt Bond Issues</u>	<u>Principal</u>	<u>Bond Rating</u>			
		<u>Moody's</u>		<u>S&amp;P</u>	
		<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Carroll County 2002 Series C	\$ 96	A2	A2	BBB+	A
Carroll County 2007 Series A	\$ 18	A2	A2	BBB+	A
Trimble County 2007 Series A	\$ 9	A2	A2	BBB+	A

During 2008, KU converted several series of its pollution control bonds from the auction rate mode to a weekly interest rate mode, as permitted under the loan documents. In connection with these conversions, the Company purchased some of the bonds from the remarketing agent. The bonds that were repurchased from the remarketing agent in 2008 were either defeased or remarketed during 2008.

As of December 31, 2009, KU had no remaining repurchased bonds. During 2008, KU refinanced and remarketed \$63 million and refinanced \$17 million of pollution control bonds that had been previously repurchased by the Company.

All of KU's first mortgage bonds were released and terminated in February 2007. Under the provisions for certain of KU's variable-rate pollution control bonds, the bonds are subject to tender for purchase at the option of the holder and to mandatory tender for purchase upon the occurrence of certain events, causing the bonds to be classified as current portion of long-term debt in the balance sheets. The average annualized interest rate for these bonds during 2009, 2008 and 2007 was 0.61%, 1.75% and 3.72%, respectively.

There were no redemptions or maturities of long-term debt for 2009. Redemptions and maturities of long-term debt for 2008 and 2007 are summarized below:

(\$ in millions)		<u>Principal</u>		<u>Secured/</u>	
<u>Year</u>	<u>Description</u>	<u>Amount</u>	<u>Rate</u>	<u>Unsecured</u>	<u>Maturity</u>
2008	Pollution control bonds	\$ 13	Variable	Secured	2035
2008	Pollution control bonds	\$ 13	Variable	Secured	2035
2008	Pollution control bonds	\$ 17	Variable	Secured	2036
2008	Pollution control bonds	\$ 17	Variable	Secured	2036
2007	Pollution control bonds	\$ 54	Variable	Secured	2024
2007	First mortgage bonds	\$ 54	7.92%	Secured	2007

Issuances of long-term debt for 2009, 2008 and 2007 are summarized below:

(\$ in millions)		<u>Principal</u>		<u>Secured/</u>	
<u>Year</u>	<u>Description</u>	<u>Amount</u>	<u>Rate</u>	<u>Unsecured</u>	<u>Maturity</u>
2009	Due to Fidelity	\$ 50	4.445%	Unsecured	2019
2009	Due to Fidelity	\$ 50	4.81%	Unsecured	2019
2009	Due to Fidelity	\$ 50	5.28%	Unsecured	2017
2008	Due to Fidelity	\$ 75	7.035%	Unsecured	2018
2008	Pollution control bonds	\$ 78	Variable	Unsecured	2032
2008	Due to Fidelity	\$ 50	6.16%	Unsecured	2018
2008	Due to Fidelity	\$ 50	5.645%	Unsecured	2018
2008	Due to Fidelity	\$ 75	5.85%	Unsecured	2023
2007	Pollution control bonds	\$ 54	Variable	Unsecured	2034



2007	Pollution control bonds	\$ 18	Variable	Unsecured	2026
2007	Pollution control bonds	\$ 9	Variable	Unsecured	2037
2007	Due to Fidelity	\$ 53	5.69%	Unsecured	2022
2007	Due to Fidelity	\$ 75	5.86%	Unsecured	2037
2007	Due to Fidelity	\$ 50	5.98%	Unsecured	2017
2007	Due to Fidelity	\$ 100	5.96%	Unsecured	2028
2007	Due to Fidelity	\$ 70	5.71%	Unsecured	2019
2007	Due to Fidelity	\$ 100	5.45%	Unsecured	2014

In February 2007, KU completed a series of financial transactions impacting its periodic reporting requirements. The \$54 million Pollution Control Series 10 bond was refinanced and replaced with a new unsecured tax-exempt bond of the same amount maturing in 2034. The \$53 million Series P bond was defeased and replaced with an intercompany loan totaling \$53 million from Fidelity. In conjunction with the defeasance, the Company terminated the related interest rate swap. Fidelity also agreed to eliminate the second lien on its two secured loans. Pursuant to the terms of the remaining tax-exempt bonds, the first mortgage bonds were cancelled and the underlying lien on substantially all of KU's assets was released following the completion of these steps. KU no longer has any secured debt and is no longer subject to periodic reporting under the Securities Exchange Act of 1934.

In October 2008, the Company issued Carroll County 2008 Series A tax exempt bonds in the amount of \$78 million. The new bonds mature on February 1, 2032, and bear interest at a variable rate. The new bonds refinance four existing bonds (Carroll County 2005 Series A and B - \$13 million each and the Carroll County 2006 Series A and C - \$17 million each), and include \$18 million of new funding. The proceeds were held in escrow pending incurrence of qualifying expenditures, but have now been used.

In December 2008, KU converted the interest rate mode of the Carroll County 2006 Series B to a weekly mode from an auction mode. The bonds along with the Carroll County 2004 Series A, the Mercer County 2000 Series A, and the Carroll County 2008 Series A, were issued with the enhancement of a letter of credit. The bonds have been reclassified as current portion of long-term debt because investors can put the bonds back to the Company on a weekly basis.

As of December 31, 2009, \$1,331 million of unsecured notes payable was outstanding to the Company's affiliate, Fidelity, with interest rates ranging from 4.24% to 7.04% and maturities ranging from 2010 to 2037.

Long-term debt maturities for KU are shown in the following table:

(in millions)	
2010	\$ 33
2011	-
2012	50
2013	175
2014	100
Thereafter	1,324 (a)
Total	<u>\$ 1,682</u>

(a) Includes long-term debt of \$228 million classified as current liabilities because these bonds are subject to tender for purchase at the option of the holder and to mandatory tender for purchase upon the occurrence of certain events. Maturity dates for these bonds range from 2023 to 2034.

## Note 8 - Notes Payable and Other Short-Term Obligations

KU participates in an intercompany money pool agreement wherein E.ON U.S. and/or LG&E make funds available to KU at market-based rates (based on highly rated commercial paper issues) up to \$400 million. Details of the balances are as follows:

(\$ in millions)	Total Money <u>Pool Available</u>	Amount <u>Outstanding</u>	Balance <u>Available</u>	Average <u>Interest Rate</u>
December 31, 2009	\$ 400	\$ 45	\$ 355	0.20%
December 31, 2008	\$ 400	\$ 16	\$ 384	1.49%

E.ON U.S. maintains revolving credit facilities totaling \$313 million at December 31, 2009 and 2008, to ensure funding availability for the money pool. At December 31, 2009 and 2008, one facility, totaling \$150 million, is with E.ON North America, Inc., while the remaining line, totaling \$163 million, is with Fidelia; both are affiliated companies. The balances are as follows:

(\$ in millions)	Total <u>Available</u>	Amount <u>Outstanding</u>	Balance <u>Available</u>	Average <u>Interest Rate</u>
December 31, 2009	\$ 313	\$ 276	\$ 37	1.25%
December 31, 2008	\$ 313	\$ 299	\$ 14	2.05%

As of December 31, 2009, the Company maintained a bilateral line of credit, with an unaffiliated financial institution, totaling \$35 million which matures in June 2012. At December 31, 2009, there was no balance outstanding under this facility.

The covenants under this revolving line of credit include the following:

- The debt/total capitalization ratio must be less than 70%
- E.ON must own at least 66.667% of voting stock of KU directly or indirectly
- The corporate credit rating of the Company must be at or above BBB- and Baa3 as determined by S&P and Moody's
- A limitation on disposing of assets aggregating more than 15% of total assets as of December 31, 2006

KU was in compliance with these covenants at December 31, 2009.

In October 2008, KU closed on a \$78 million bilateral line of credit which had a 364 day maturity. This facility was terminated in December 2008 and replaced by four new letter of credit facilities to allow issuance of letters of credit totaling \$198 million to support tax-exempt bonds totaling \$195 million of the \$228 million of bonds that can be put back to the Company. Should the holders elect to put the bonds back and they cannot be remarketed, the letter of credit would fund the investor's payment. The expiration date for the letters of credit has been extended to December 2010. The reimbursement agreements are identical and contain the following covenants:

- E.ON must own 75% of voting stock of KU directly or indirectly
- A limitation on disposing of assets aggregating more than 20% of total assets as of most recent quarter-end.

At December 31, 2009, KU had no remaining capacity for letters of credit under these facilities and was in compliance with these covenants.

## Note 9 - Commitments and Contingencies

**Operating Leases.** KU leases office space, office equipment, plant equipment, real estate, railcars, telecommunications and vehicles and accounts for these leases as operating leases. In addition, KU reimburses LG&E for a portion of the lease expense paid by LG&E for KU's usage of office space leased by LG&E. Total lease expense was \$10 million, \$9 million and \$6 million for 2009, 2008 and 2007, respectively. The future minimum annual lease payments for operating leases for years subsequent to December 31, 2009, are shown in the following table:

(in millions)	
2010	\$ 7
2011	6
2012	5
2013	4
2014	4
Thereafter	3
Total	<u>\$ 29</u>

**Owensboro Contract Litigation.** In May 2004, the City of Owensboro, Kentucky and OMU commenced a suit which was removed to the U.S. District Court for the Western District of Kentucky, against KU concerning a long-term power supply contract (the "OMU Agreement") with KU. The dispute involved interpretational differences regarding issues under the OMU Agreement, including various payments or charges between KU and OMU and rights concerning excess power, termination and emissions allowances. In July 2005, the court issued a summary judgment ruling upholding OMU's contractual right to terminate the OMU agreement in May 2010.

In September and October 2008, the court granted rulings on a number of summary judgment petitions in the Company's favor. The summary judgment rulings resulted in the dismissal of all of OMU's remaining claims against the Company. The trial on KU's counterclaim occurred during October and November 2008. During February 2009, the court issued orders on the matters covered at trial, including (i) awarding the Company an aggregate \$9 million relating to the cost of NOx allowances charged by OMU to KU and the price of back-up power purchased by OMU from KU, plus pre- and post-judgment interest, and (ii) denying the Company's claim for damages based upon sub-par operations and availability of the OMU units. In April 2009, the court issued a ruling on various post-trial motions denying certain challenges to calculation elements of the \$9 million award or of interest amounts associated therewith. In May 2009, KU and OMU executed a settlement agreement resolving the matter on a basis consistent with the court's prior rulings and the Company has received the agreed settlement amounts.

**Sale and Leaseback Transaction.** The Company is a participant in a sale and leaseback transaction involving its 62% interest in two jointly owned CTs at KU's E.W. Brown generating station (Units 6 and 7). Commencing in December 1999, KU and LG&E entered into a tax-efficient, 18-year lease of the CTs. KU and LG&E have provided funds to fully defease the lease, and have executed an irrevocable notice to exercise an early purchase option contained in the lease after 15.5 years. The financial statement treatment of this transaction is no different than if KU had retained its ownership. The leasing transaction was entered into following receipt of required state and federal regulatory approvals.

In case of default under the lease, the Company is obligated to pay to the lessor its share of certain fees or amounts. Primary events of default include loss or destruction of the CTs, failure to insure or maintain the CTs and unwinding of the transaction due to governmental actions. No events of default

currently exist with respect to the lease. Upon any termination of the lease, whether by default or expiration of its term, title to the CTs reverts jointly to KU and LG&E.

At December 31, 2009, the maximum aggregate amount of default fees or amounts was \$8 million, of which KU would be responsible for 62% (approximately \$5 million). The Company has made arrangements with E.ON U.S., via guarantee and regulatory commitment, for E.ON U.S. to pay its full portion of any default fees or amounts.

**Letter of Credit.** KU has provided letters of credit totaling \$198 million supporting bonds of \$195 million and a letter of credit totaling less than \$1 million to support certain obligations related to workers' compensation.

**Power Purchases.** The Company has power purchase arrangements with OMU and OVEC. Under the OMU agreement, which will be terminated by OMU in May 2010, KU purchases all of the output of an approximately 400-Mw coal-fired generating station not required by OMU. The amount of power purchases available to the Company during 2010, which is expected to be approximately 5% of KU's total Kwh native load energy requirements, is dependent upon a number of factors including the OMU units' availability, maintenance schedules, fuel costs and OMU requirements. Payments are based on the total costs of the station allocated per terms of the OMU agreement. Included in the total costs is KU's proportionate share of debt service requirements on \$207 million of OMU bonds outstanding at December 31, 2009. The debt service is allocated to KU based on its annual allocated share of capacity, which averaged approximately 44% in 2009. KU does not guarantee the OMU bonds, or any requirements therein, in the event of default by OMU.

KU has a contract for power purchases with OVEC, terminating in 2026, for various Mw capacities. KU has an investment of 2.5% ownership in OVEC's common stock, which is accounted for on the cost method of accounting. The Company's share of OVEC's output is 2.5%, approximately 55 Mw of generation capacity. Future obligations for power purchases are shown in the following table:

(in millions)	
2010	\$ 16
2011	10
2012	10
2013	11
2014	12
Thereafter	<u>177</u>
Total	<u>\$ 236</u>

**Coal and Gas Purchase Obligations.** KU has contracts to purchase coal and natural gas transportation. Future obligations are shown in the following table:

(in millions)	
2010	\$ 391
2011	307
2012	145
2013	88
2014	92
Thereafter	- (a)
Total	<u>\$ 1,023</u>

(a) Obligations after 2014 are indexed to future market prices and are not included above since prices will be set in the future using the contracted methodology.

**Construction Program.** KU had \$62 million of commitments in connection with its construction program at December 31, 2009.

In June 2006, KU and LG&E entered into a construction contract regarding the TC2 project. The contract is generally in the form of a lump-sum, turnkey agreement for the design, engineering, procurement, construction, commissioning, testing and delivery of the project, according to designated specifications, terms and conditions. The contract price and its components are subject to a number of potential adjustments which may serve to increase or decrease the ultimate construction price paid or payable to the contractor. The contract also contains standard representations, covenants, indemnities, termination and other provisions for arrangements of this type, including termination for convenience or for cause rights. In March 2009, the parties completed an agreement resolving certain construction cost increases due to higher labor and per diem costs above an established baseline, and certain safety and compliance costs resulting from a change in law. The Company's share of additional costs from inception of the contract through the expected project completion in 2010 is estimated to be approximately \$30 million. During the past and to date in 2010, KU and LG&E have received a number of contractual notices from the TC2 construction contractor asserting force majeure/excusable event claims for adjustments to either or both of contract price or construction schedule with respect to certain events which, if granted, may affect such contractual terms in addition to a possible extension of the commercial operations date, liquidated damages or other relevant provisions. The parties are continuing to discuss such matters in good faith and to resolve them in a commercially reasonable manner. The Company cannot currently estimate the ultimate outcome of these matters, including the extent, if any, that it results in increased costs charged for construction of TC2 and/or relief relating to the construction completion or operations dates.

**TC2 Air Permit.** The Sierra Club and other environmental groups filed a petition challenging the air permit issued for the TC2 baseload generating unit which was issued by the Kentucky Division for Air Quality ("KDAQ") in November 2005. In September 2007, the Secretary of the Kentucky Environmental and Public Protection Cabinet issued a final Order upholding the permit. The environmental groups petitioned the EPA to object to the state permit and subsequent permit revisions. In determinations made in September 2008 and June 2009, the EPA rejected most of the environmental groups' claims, but identified three permit deficiencies which the KDAQ addressed by revising the permit. In August 2009, the EPA issued an order denying the remaining claims with the exception of two additional deficiencies which the KDAQ was directed to address. The EPA determined that the proposed permit subsequently issued by the KDAQ satisfied the conditions of the EPA Order, although the agency recommended certain enhancements to the administrative record. In January 2010, the

KDAQ issued a final permit revision incorporating the proposed changes to address the two EPA objections. In March 2010, the Sierra Club submitted a petition to the EPA to object to the permit revision, which petition is now pending before the EPA. The Company believes that the final permit as revised should not have a material adverse effect on its financial condition or results of operations. However, until the right to challenge the final permit expires, the Company cannot predict the final outcome of this matter.

**Thermostat Replacement.** During January 2010, KU and LG&E announced a voluntary plan to replace certain thermostats which had been provided to customers as part of the Companies' demand reduction programs, due to concerns that the thermostats may present a safety hazard. Under the plan, the Companies anticipate replacing up to approximately 14,000 thermostats. Estimated costs associated with the replacement program may be \$2 million. However, the Companies cannot fully predict the ultimate outcome of the replacement program or other effects or developments which may be associated with the thermostat replacement matter at this time.

**Reserve Sharing Developments.** The membership of KU and LG&E in the Midwest Contingency Reserve Sharing Group terminated on December 31, 2009. In December 2009, the Companies entered into arrangements with Tennessee Valley Authority and East Kentucky Power Cooperative to form a new reserve sharing group, the TEE Contingency Reserve Sharing Group. Contingency reserves, including spinning reserves and supplemental reserves, relate to power or capacity requirements that the Companies must have available for certain reliability purposes. In general, the operational and financial impact of reserve sharing arrangements varies based upon factors such as the terms of the agreement, the relative generating and operations conduct of the parties and relevant market prices. While the Companies do not anticipate the revised reserve sharing developments will have a material adverse effect on their prospective operations or financial condition, such outcome cannot be guaranteed.

**Mine Safety Compliance Costs.** In March 2006, the Mine Safety and Health Administration enacted Emergency Temporary Standards regulations and has issued additional regulations as the result of the passage of the Mine Improvement and New Emergency Response Act of 2006, which was signed into law in June 2006. At the state level, Kentucky and other states that supply coal to KU, have passed new mine safety legislation. These pieces of legislation require all underground coal mines to implement new safety measures and install new safety equipment. Under the terms of the majority of the long-term coal contracts the Company has in place, provisions are made to allow for price adjustments for compliance costs resulting from new or amended laws or regulations. KU's coal suppliers regularly submit price adjustments related to these compliance costs. The Company employs an external consultant to review all relevant mine safety compliance cost claims for validity and reasonableness. Depending upon the terms of the contracts and commercial practice, the Company may delay payment of the adjustments or pay certain adjustments subject to refund. At appropriate times in the review, payment or refund processes, KU may make adjustments to the values or amounts or values of inventory, accounts receivable or accounts payable relating to coal matters. In general, the Company expects to recover these coal-related cost adjustments through the FAC.

**Environmental Matters.** The Company's operations are subject to a number of environmental laws and regulations in each of the jurisdictions in which it operates, governing, among other things, air emissions, wastewater discharges, the use, handling and disposal of hazardous substances and wastes, soil and groundwater contamination and employee health and safety.

*Clean Air Act Requirements.* The Clean Air Act establishes a comprehensive set of programs aimed at protecting and improving air quality in the United States by, among other things, controlling stationary sources of air emissions such as power plants. While the general regulatory framework for these

programs is established at the federal level, most of the programs are implemented and administered by the states under the oversight of the EPA. The key Clean Air Act programs relevant to KU's business operations are described below.

*Ambient Air Quality.* The Clean Air Act requires the EPA to periodically review the available scientific data for six criteria pollutants and establish concentration levels in the ambient air sufficient to protect the public health and welfare with an extra margin for safety. These concentration levels are known as National Ambient Air Quality Standards ("NAAQS"). Each state must identify "nonattainment areas" within its boundaries that fail to comply with the NAAQS and develop a SIP to bring such nonattainment areas into compliance. If a state fails to develop an adequate plan, the EPA must develop and implement a plan. As the EPA increases the stringency of the NAAQS through its periodic reviews, the attainment status of various areas may change, thereby triggering additional emission reduction obligations under revised SIPs aimed to achieve attainment.

In 1997, the EPA established new NAAQS for ozone and fine particulates that required additional reductions in SO<sub>2</sub> and NO<sub>x</sub> emissions from power plants. In 1998, the EPA issued its final "NO<sub>x</sub> SIP Call" rule requiring reductions in NO<sub>x</sub> emissions of approximately 85% from 1990 levels in order to mitigate ozone transport from the midwestern U.S. to the northeastern U.S. To implement the new federal requirements, Kentucky amended its SIP in 2002 to require electric generating units to reduce their NO<sub>x</sub> emissions to 0.15 pounds weight per MMBtu on a company-wide basis. In 2005, the EPA issued the CAIR which required additional SO<sub>2</sub> emission reductions of 70% and NO<sub>x</sub> emission reductions of 65% from 2003 levels. The CAIR provided for a two-phase cap and trade program, with initial reductions of NO<sub>x</sub> and SO<sub>2</sub> emissions due by 2009 and 2010, respectively, and final reductions due by 2015. In 2006, Kentucky proposed to amend its SIP to adopt state requirements similar to those under the federal CAIR. Depending on the level of action determined necessary to bring local nonattainment areas into compliance with the new ozone and fine particulate standards, KU's power plants are potentially subject to additional reductions in SO<sub>2</sub> and NO<sub>x</sub> emissions. In January 2010, EPA issued a proposed rule to reconsider the NAAQS for Ozone, previously revised in 2008. The proposal would institute more stringent standards. At present, the Company is unable to determine what, if any, additional requirements may be imposed to achieve compliance with the new ozone standard.

In July 2008, a federal appeals court issued a ruling finding deficiencies in the CAIR and vacating it. In December 2008, the Court amended its previous Order, directing the EPA to promulgate a new regulation, but leaving the CAIR in place in the interim. Depending upon the course of such matters, the CAIR could be superseded by new or revised NO<sub>x</sub> or SO<sub>2</sub> regulations with different or more stringent requirements and SIPs which incorporate CAIR requirements could be subject to revision. KU is also reviewing aspects of its compliance plan relating to the CAIR, including scheduled or contracted pollution control construction programs. Finally, as discussed below, the remand of the CAIR results in some uncertainty with respect to certain other EPA or state programs and proceedings and the Companies' compliance plans relating thereto, due to the interconnection of the CAIR with such associated programs. At present, KU is not able to predict the outcomes of the legal and regulatory proceedings related to the CAIR and whether such outcomes could have a material effect on the Company's financial or operational conditions.

*Hazardous Air Pollutants.* As provided in the Clean Air Act, as amended, the EPA investigated hazardous air pollutant emissions from electric utilities and submitted a report to Congress identifying mercury emissions from coal-fired power plants as warranting further study. In 2005, the EPA issued the Clean Air Mercury Rule ("CAMR") establishing mercury standards for new power plants and requiring all states to issue new SIPs including mercury requirements for existing power plants. The EPA issued a model rule which provides for a two-phase cap and trade program with initial reductions due by 2010

and final reductions due by 2018. The CAMR provided for reductions of 70% from 2003 levels. The EPA closely integrated the CAMR and CAIR programs to ensure that the 2010 mercury reduction targets would be achieved as a “co-benefit” of the controls installed for purposes of compliance with the CAIR.

In February 2008, a federal appellate court issued a decision vacating the CAMR. The EPA has announced that it intends to promulgate a new rule to replace the CAMR. Depending on the final outcome of the rulemaking, the CAMR could be replaced by new mercury reduction rules with different or more stringent requirements. Kentucky has also repealed its corresponding state mercury regulations. At present, KU is not able to predict the outcomes of the legal and regulatory proceedings related to the CAMR and whether such outcomes could have a material effect on the Company’s financial or operational conditions.

*Acid Rain Program.* The Clean Air Act, as amended, imposed a two-phased cap and trade program to reduce SO<sub>2</sub> emissions from power plants that were thought to contribute to “acid rain” conditions in the northeastern U.S. The Clean Air Act, as amended, also contains requirements for power plants to reduce NO<sub>x</sub> emissions through the use of available combustion controls.

*Regional Haze.* The Clean Air Act also includes visibility goals for certain federally designated areas, including national parks, and requires states to submit SIPs that will demonstrate reasonable progress toward preventing future impairment and remedying any existing impairment of visibility in those areas. In 2005, the EPA issued its Clean Air Visibility Rule (“CAVR”) detailing how the Clean Air Act’s Best Available Retrofit Technology (“BART”) requirements will be applied to facilities, including power plants, built between 1962 and 1974 that emit certain levels of visibility impairing pollutants. Under the final rule, as the CAIR provided for more visibility improvement than BART, states are allowed to substitute CAIR requirements in their regional haze SIPs in lieu of controls that would otherwise be required by BART. The final rule has been challenged in the courts. Additionally, because the regional haze SIPs incorporate certain CAIR requirements, the remand of CAIR could potentially impact regional haze SIPs. See “Ambient Air Quality” above for a discussion of CAIR-related uncertainties.

*Installation of Pollution Controls.* Many of the programs under the Clean Air Act utilize cap and trade mechanisms that require a company to hold sufficient emissions allowances to cover its authorized emissions on a company-wide basis and do not require installation of pollution controls on every generating unit. Under cap and trade programs, companies are free to focus their pollution control efforts on plants where such controls are particularly efficient and utilize the resulting emission allowances for smaller plants where such controls are not cost effective. KU met its Phase I SO<sub>2</sub> requirements primarily through installation of FGD equipment on Ghent Unit 1. KU’s strategy for its Phase II SO<sub>2</sub> requirements, which commenced in 2000, includes the installation of additional FGD equipment, as well as using accumulated emission allowances and fuel switching to defer certain additional capital expenditures. In order to achieve the NO<sub>x</sub> emission reductions and associated obligations, KU installed additional NO<sub>x</sub> controls, including SCR technology, during the 2000 through 2009 time period at a cost of \$221 million. In 2001, the Kentucky Commission granted approval to recover the costs incurred by KU for these projects through the environmental surcharge mechanism. Such monthly recovery is subject to periodic review by the Kentucky Commission.

In order to achieve mandated emissions reductions, KU expects to incur additional capital expenditures totaling approximately \$320 million during the 2010 through 2012 time period for pollution controls including FGD and SCR equipment, and additional operating and maintenance costs in operating such controls. In 2005, the Kentucky Commission granted approval to recover the costs incurred by the Company for these projects through the ECR mechanism. Such monthly recovery is subject to periodic



review by the Kentucky Commission. KU believes its costs in reducing SO<sub>2</sub>, NO<sub>x</sub> and mercury emissions to be comparable to those of similarly situated utilities with like generation assets. KU's compliance plans are subject to many factors including developments in the emission allowance and fuels markets, future legislative and regulatory enactments, legal proceedings and advances in clean air technology. KU will continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective manner. See "Ambient Air Quality" above for a discussion of CAIR-related uncertainties.

*GHG Developments.* In 2005, the Kyoto Protocol for reducing GHG emissions took effect, obligating 37 industrialized countries to undertake substantial reductions in GHG emissions. The U.S. has not ratified the Kyoto Protocol and there are currently no mandatory GHG emission reduction requirements at the federal level. As discussed below, legislation mandating GHG reductions has been introduced in the Congress, but no federal legislation has been enacted to date. In the absence of a program at the federal level, various states have adopted their own GHG emission reduction programs. Such programs have been adopted in various states including 11 northeastern U.S. states and the District of Columbia under the Regional GHG Initiative program and California. Substantial efforts to pass federal GHG legislation are on-going. The current administration has announced its support for the adoption of mandatory GHG reduction requirements at the federal level. The United States and other countries met in Copenhagen, Denmark in December 2009, in an effort to negotiate a GHG reduction treaty to succeed the Kyoto Protocol, which is set to expire in 2013. At Copenhagen, the U.S. made a nonbinding commitment to, among other things, seek to reduce GHG emissions to 17% below 2005 levels by 2020 and provide financial support to developing countries. The United States and other nations are scheduled to meet in Cancun, Mexico in late 2010 to continue negotiations toward a binding agreement.

*GHG Legislation.* KU is monitoring on-going efforts to enact GHG reduction requirements and requirements governing carbon sequestration at the state and federal level and is assessing potential impacts of such programs and strategies to mitigate those impacts. In June 2009, the U.S. House of Representatives passed the American Clean Energy and Security Act of 2009, (H.R. 2454), which is a comprehensive energy bill containing the first-ever nation-wide GHG cap and trade program. If enacted into law, the bill would provide for reductions in GHG emissions of 3% below 2005 levels by 2012, 17% by 2020, and 83% by 2050. In order to cushion potential rate impacts for utility customers, approximately 43% of emissions allowances would initially be allocated at no cost to the electric utility sector, with this allocation gradually declining to 7% in 2029 and zero thereafter. The bill would also establish a renewable electricity standard requiring utilities to meet 20% of their electricity demand through renewable energy and energy efficiency by 2020. The bill contains additional provisions regarding carbon capture and sequestration, clean transportation, smart grid advancement, nuclear and advanced technologies and energy efficiency.

In September 2009, the Clean Energy Jobs and American Power Act (S. 1733), which is largely patterned on the House legislation, was introduced in the U.S. Senate. The Senate bill raises the emissions reduction target for 2020 to 20% below 2005 levels and does not include a renewable electricity standard. While the initial bill lacked detailed provisions for the allocation of emissions allowances, a subsequent revision has incorporated allowance allocation provisions similar to the House bill. The Company is closely monitoring the progress of the legislation, although the prospect for passage of comprehensive GHG legislation in 2010 is uncertain.

*GHG Regulations.* In April 2007, the U.S. Supreme Court ruled that the EPA has the authority to regulate GHG under the Clean Air Act. In April 2009, the EPA issued a proposed endangerment finding concluding that GHGs endanger public health and welfare, which is an initial rulemaking step under the Clean Air Act. A final endangerment finding was issued in December 2009. In September 2009, the

EPA issued a final GHG reporting rule requiring reporting by facilities with annual GHG emissions equivalent to at least 25,000 tons of carbon dioxide. A number of the Company's facilities will be required to submit annual reports commencing with calendar year 2010. Also in September 2009, the EPA proposed to require new or modified sources with GHG emissions equivalent to at least 10,000 to 25,000 tons of carbon dioxide to obtain permits under the Prevention of Significant Deterioration Program. Such new or modified facilities would be required to install Best Available Control Technology. While the Company is unaware of any currently available GHG control technology that might be required for installation on new or modified power plants, it is currently assessing the potential impact of the proposed rule. A final rule is expected in 2010.

The Company is unable to predict whether mandatory GHG reduction requirements will ultimately be enacted through legislation or regulations. As a company with significant coal-fired generating assets, KU could be substantially impacted by programs requiring mandatory reductions in GHG emissions, although the precise impact on its operations, including the reduction targets and deadlines that would be applicable, cannot be determined prior to the enactment of such programs. While the Company believes that many costs of complying with mandatory GHG reduction requirements or purchasing emission allowances to meet applicable requirements would likely be recoverable, in whole or in part under the ECR, where such costs are related to the Company's coal-fired generating assets, or other potential cost-recovery mechanisms, this cannot be assured.

*GHG Litigation.* A number of lawsuits have been filed asserting common law claims including nuisance, trespass and negligence against various companies with GHG emitting facilities. In October 2009, a three judge panel of the United States Court of Appeals for the 5<sup>th</sup> Circuit in the case of *Comer v. Murphy Oil* reversed a lower court, holding that private plaintiffs have standing to assert certain common law claims against more than 30 utility, oil, coal and chemical companies. However, in March 2010, the court vacated the opinion of the three-judge panel and granted a motion for rehearing. The *Comer* complaint alleges that GHG emissions from the defendants' facilities contributed to global warming which increased the intensity of Hurricane Katrina. E.ON, the parent of KU and LG&E was included as a defendant in the complaint, but has not been subject to the proceedings due to the failure of the plaintiffs to pursue service under the applicable international procedures. KU and LG&E are currently unable to predict further developments in the *Comer* case. KU and LG&E continue to monitor relevant GHG litigation to identify judicial developments that may be potentially relevant to their operations.

*Brown New Source Review Litigation.* In April 2006, the EPA issued an NOV alleging that KU had violated certain provisions of the Clean Air Act's new source review rules relating to work performed in 1997, on a boiler and turbine at KU's E.W. Brown generating station. In December 2006, the EPA issued a second NOV alleging the Company had exceeded heat input values in violation of the air permit for the unit. In March 2007, the Department of Justice filed a complaint in federal court in Kentucky alleging the same violations specified in the prior NOVs. The complaint sought civil penalties, including potential per-day fines, remedial measures and injunctive relief. In December 2008, the Company reached a tentative settlement with the government resolving all outstanding claims. The proposed consent decree, which was approved by the court in March 2009, provides for payment of a \$1 million civil penalty; funding of \$3 million in environmental mitigation projects; surrender of 53,000 excess SO<sub>2</sub> allowances; surrender of excess NO<sub>x</sub> allowances estimated at 650 allowances annually for eight years; installation of an FGD by December 31, 2010; installation of an SCR by December 31, 2012; and compliance with specified emission limits and operational restrictions.

*Section 114 Requests.* In August 2007, the EPA issued administrative information requests under Section 114 of the Clean Air Act requesting new source review-related data regarding certain projects

undertaken at LG&E's Mill Creek 4 and TC1 generating units and KU's Ghent 2 generating unit. KU and LG&E have complied with the information requests and are not able to predict further proceedings in this matter at this time.

*Ghent Opacity NOV.* In September 2007, the EPA issued an NOV alleging that KU had violated certain provisions of the Clean Air Act's operating rules relating to opacity during June and July of 2007 at Units 1 and 3 of KU's Ghent generating station. The parties have met on this matter and KU has received no further communications from the EPA. The Company is not able to estimate the outcome or potential effects of these matters, including whether substantial fines, penalties or remedial measures may result.

*Ghent New Source Review NOV.* In March 2009, the EPA issued an NOV alleging that KU violated certain provisions of the Clean Air Act's rules governing new source review and prevention of significant deterioration by installing FGD and SCR controls at its Ghent generating station without assessing potential increased sulfuric acid mist emissions. KU contends that the work in question, as pollution control projects, was exempt from the requirements cited by the EPA. In December 2009, the EPA issued a Section 114 information request seeking additional information on this matter. The Company is currently unable to determine the final outcome of this matter or the impact of an unfavorable determination upon the Company's financial position or results of operations.

*Ash Ponds, Coal-Combustion Byproducts and Water Discharges.* The EPA has undertaken various initiatives in response to the December 2008 impoundment failure at the Tennessee Valley Authority's Kingston power plant, which resulted in a major release of coal combustion byproducts into the environment. The EPA issued information requests to utilities throughout the country, including KU, to obtain information on their ash ponds and other impoundments. In addition, the EPA inspected a large number of impoundments located at power plants to determine their structural integrity. The inspections included several of the Company's impoundments, which the EPA found to be in satisfactory condition. The Company is awaiting final inspection reports for additional impoundments. The EPA and other agencies are currently considering the need to revise applicable standards governing the structural integrity of ash ponds and other impoundments. In addition, the EPA has announced that it is re-evaluating current regulatory requirements applicable to coal combustion byproducts and anticipates proposing new rules by early 2010. The EPA is considering a wide range of regulatory options including subjecting ash ponds and landfills handling coal combustion byproducts to regulation under the hazardous waste program. Finally, the EPA has announced plans to develop revised effluent limitations guidelines and standards governing discharges from power plants. The Company is monitoring these ongoing regulatory developments, but will be unable to determine the impact until such time as new rules are finalized.

*General Environmental Proceedings.* From time to time, KU appears before the EPA, various state or local regulatory agencies and state and federal courts regarding matters involving compliance with applicable environmental laws and regulations. Such matters include a completed settlement with state regulators regarding particulate limits in the air permit for KU's Tyrone generating station, remediation activities for, or other risks relating to elevated Polychlorinated Biphenyl ("PCB") levels at existing properties, and liability under the Comprehensive Environmental Response, Compensation and Liability Act for cleanup at various off-site waste sites. Based on analysis to date, the resolution of these matters is not expected to have a material impact on the Company's operations.

## Note 10 - Jointly Owned Electric Utility Plant

KU and LG&E are nearing completion of TC2, a jointly owned unit at the Trimble County site. KU and LG&E own undivided 60.75% and 14.25% interests, respectively, in TC2. Of the remaining 25% of TC2, IMEA owns a 12.12% undivided interest and IMPA owns a 12.88% undivided interest. Each company is responsible for its proportionate share of capital cost during construction, and fuel, operation and maintenance cost when TC2 begins operation, which is scheduled to occur in 2010. In December 2009 and June 2008, LG&E sold assets to KU related to the construction of TC2 with a net book value of \$48 million and \$10 million, respectively.

The following data represent shares of the jointly owned property (capacity based on nameplate rating):

	TC2				
	LG&E	KU	IMPA	IMEA	Total
Ownership interest	14.25%	60.75%	12.88%	12.12%	100%
Mw capacity	119	509	108	102	838

(in millions)

KU's 60.75% ownership:		LG&E's 14.25% ownership:	
Plant held for future use	\$: 121	Plant held for future use	\$ 5
Construction work in progress	679	Construction work in progress	169
Accumulated depreciation	63	Accumulated depreciation	2
Net book value	<u>\$: 737</u>	Net book value	<u>\$ 172</u>

KU and LG&E jointly own the following CTs and related equipment (capacity based on net summer capability):

(\$ in millions)	KU				LG&E				Total			
	Mw Capacity	(\$) Cost	(\$) Depre- ciation	(\$) Net Book Value	Mw Capacity	(\$) Cost	(\$) Depre- ciation	(\$) Net Book Value	Mw Capacity	(\$) Cost	(\$) Depre- ciation	(\$) Net Book Value
Ownership Percentage												
KU 47%, LG&E 53% (a)	129	54	(13)	41	146	59	(15)	44	275	113	(28)	85
KU 62%, LG&E 38% (b)	190	79	(15)	64	118	46	(7)	39	308	125	(22)	103
KU 71%, LG&E 29% (c)	228	82	(21)	61	92	33	(8)	25	320	115	(29)	86
KU 63%, LG&E 37% (d)	404	140	(25)	115	236	82	(16)	66	640	222	(41)	181
KU 71%, LG&E 29% (e)	n/a	9	(2)	7	n/a	3	(1)	2	n/a	12	(3)	9

- (a) Comprised of Paddy's Run 13 and E.W. Brown 5. In addition to the above jointly owned utility plant, there is an inlet air cooling system attributable to unit 5 and units 8-11 at the E.W. Brown facility. This inlet air cooling system is not jointly owned, however, it is used to increase production on the units to which it relates, resulting in an additional 88 Mw of capacity for KU.
- (b) Comprised of units 6 and 7 at the E.W. Brown facility.
- (c) Comprised of units 5 and 6 at the Trimble County facility.
- (d) Comprised of CT Substation 7-10 and units 7, 8, 9 and 10 at the Trimble County facility.
- (e) Comprised of CT Substation 5 and 6 and CT Pipeline at the Trimble County facility.

Both KU's and LG&E's participating share of direct expenses of the jointly owned plants is included in

the corresponding operating expenses on each company's respective income statement (e.g., fuel, maintenance of plant, other operating expense).

### Note 11 - Related Party Transactions

KU, subsidiaries of E.ON U.S. and subsidiaries of E.ON engage in related party transactions. These transactions are generally performed at cost and are in accordance with the FERC regulations under PUHCA 2005 and the applicable Kentucky Commission and Virginia Commission regulations. The significant related party transactions are disclosed below.

#### Electric Purchases

KU and LG&E purchase energy from each other in order to effectively manage the load of their retail and wholesale customers. These sales and purchases are included in the statements of income as operating revenues and purchased power operating expense. KU intercompany electric revenues and purchased power expense for the years ended December 31, were as follows:

(in millions)	<u>2009</u>	<u>2008</u>	<u>2007</u>
Electric operating revenues from LG&E	\$ 21	\$ 80	\$ 46
Power purchased from LG&E	101	109	93

#### Interest Charges

See Note 8, Notes Payable and Other Short-Term Obligations, for details of intercompany borrowing arrangements. Intercompany agreements do not require interest payments for receivables related to services provided when settled within 30 days.

KU's intercompany interest income and expense for the years ended December 31, were as follows:

(in millions)	<u>2009</u>	<u>2008</u>	<u>2007</u>
Interest on money pool loans	\$ -	\$ 2	\$ 6
Interest on Fidelia loans	69	56	35

#### Other Intercompany Billings

E.ON U.S. Services provides KU with a variety of centralized administrative, management and support services. These charges include payroll taxes paid by E.ON U.S. Services on behalf of KU, labor and burdens of E.ON U.S. Services employees performing services for KU, coal purchases and other vouchers paid by E.ON U.S. Services on behalf of KU. The cost of these services is directly charged to KU, or for general costs which cannot be directly attributed, charged based on predetermined allocation factors, including the following ratios: number of customers, total assets, revenues, number of employees and other statistical information. These costs are charged on an actual cost basis.

In addition, KU and LG&E provide services to each other and to E.ON U.S. Services. Billings between KU and LG&E relate to labor and overheads associated with union employees performing work for the other utility, charges related to jointly-owned generating units and other miscellaneous charges. Billings from KU to E.ON U.S. Services include cash received by E.ON U.S. Services on behalf of KU, primarily tax settlements, and other payments made by KU on behalf of other non-regulated businesses which are reimbursed through E.ON U.S. Services.

Intercompany billings to and from KU for the years ended December 31, were as follows:

(in millions)	<u>2009</u>	<u>2008</u>	<u>2007</u>
E.ON U.S. Services billings to KU	\$ 169	\$ 227	\$ 488
LG&E billings to KU	44	5	12
KU billings to E.ON U.S. Services	14	3	26
KU billings to LG&E	78	75	6

In December 2009 and June 2008, LG&E sold assets to KU related to the construction of TC2, including \$3 million of unamortized investment tax credits, with net book values of \$48 million and \$10 million, respectively.

In March and June 2009, the Company received capital contributions of \$50 million and \$25 million, respectively, from its common shareholder, E.ON U.S.

In 2008 and 2007, KU received capital contributions from its common shareholder, E.ON U.S., totaling \$145 million and \$75 million, respectively.

#### **Note 12 – Subsequent Events**

Subsequent events have been evaluated through March 19, 2010, the date of issuance of these statements and these statements contain all necessary adjustments and disclosures resulting from that evaluation.

On March 4, 2010, the Virginia Commission approved the stipulation related to the rate increase filing with rates to become effective in April 2010.

On January 29, 2010, KU filed an application with the Kentucky Commission requesting an increase in base electric rates of approximately 12%, or \$135 million annually, including an 11.5% return on equity. KU has requested the increase, based on the twelve month test year ended October 31, 2009, to become effective on and after March 1, 2010. The requested rates have been suspended until August 1, 2010, at which time they may be put into effect, subject to refund, if the Kentucky Commission has not issued an order in the proceeding.

On January 13, 2010, the Company made a \$13 million contribution to its pension plan.

## Report of Independent Auditors

To the Shareholder of Kentucky Utilities Company:

In our opinion, the accompanying balance sheets and the related statements of capitalization, income, retained earnings, and cash flows present fairly, in all material respects, the financial position of Kentucky Utilities Company at December 31, 2009 and 2008, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assertion of the effectiveness of internal control over financial reporting, included in "Controls and Procedures" appearing on page 23 of the 2009 Kentucky Utilities Company financial statements and additional information. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits of the financial statements in accordance with auditing standards generally accepted in the United States of America and our audit of internal control over financial reporting in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process affected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and those charged with governance; and (iii) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

*PricewaterhouseCoopers LLP*

Louisville, Kentucky  
March 19, 2010





**Kentucky Utilities Company**

Financial Statements and Additional Information

As of December 31, 2010 and 2009 and

for the years ended December 31, 2010, 2009 and 2008

## Index of Abbreviations

AG	Attorney General of Kentucky
ARO	Asset Retirement Obligation
ASC	Accounting Standards Codification
BART	Best Available Retrofit Technology
CAIR	Clean Air Interstate Rule
CAMR	Clean Air Mercury Rule
CATR	Clean Air Transport Rule
CCN	Certificate of Public Convenience and Necessity
Clean Air Act	The Clean Air Act, as amended in 1990
CMRG	Carbon Management Research Group
Company	Kentucky Utilities Company
CT	Combustion Turbine
DSM	Demand Side Management
ECR	Environmental Cost Recovery
EEI	Electric Energy, Inc.
EKPC	East Kentucky Power Cooperative, Inc.
E.ON	E.ON AG
E.ON U.S.	E.ON U.S. LLC and Subsidiaries
EPA	U.S. Environmental Protection Agency
EPAAct 2005	Energy Policy Act of 2005
FAC	Fuel Adjustment Clause
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
FGD	Flue Gas Desulfurization
Fidelia	Fidelia Corporation (an E.ON affiliate)
GAAP	U.S. Generally Accepted Accounting Principles
GAC	Group Annuity Contract
GHG	Greenhouse Gas
Gwh	Gigawatt hours or one thousand Mwh
IBEW	International Brotherhood of Electrical Workers
IMEA	Illinois Municipal Electric Agency
IMPA	Indiana Municipal Power Agency
IRS	Internal Revenue Service
KCCS	Kentucky Consortium for Carbon Storage
KDAQ	Kentucky Division for Air Quality
Kentucky Commission	Kentucky Public Service Commission
KIUC	Kentucky Industrial Utility Consumers, Inc.
KU	Kentucky Utilities Company
kWh	Kilowatt hours
LG&E	Louisville Gas and Electric Company
LIBOR	London Interbank Offered Rate
LKE	LG&E and KU Energy LLC and Subsidiaries (formerly E.ON U.S. LLC and Subsidiaries)
MISO	Midwest Independent Transmission System Operator, Inc.
MMBtu	Million British thermal units

## Index of Abbreviations

Moody's	Moody's Investor Services, Inc.
MVA	Megavolt-ampere
Mw	Megawatts
Mwh	Megawatt hours
NAAQS	National Ambient Air Quality Standards
NERC	North American Electric Reliability Corporation
NO <sub>2</sub>	Nitrogen Dioxide
NOV	Notice of Violation
NOx	Nitrogen Oxide
OATT	Open Access Transmission Tariff
OMU	Owensboro Municipal Utilities
OVEC	Ohio Valley Electric Corporation
PPL	PPL Corporation
Predecessor	The Company during the time period prior to November 1, 2010
PUHCA 2005	Public Utility Holding Company Act of 2005
RSG	Revenue Sufficiency Guarantee
S&P	Standard & Poor's Rating Service
SCR	Selective Catalytic Reduction
SERC	SERC Reliability Corporation
Servco	LG&E and KU Services Company (formerly E.ON U.S. Services Inc.)
SIP	State Implementation Plan
SO <sub>2</sub>	Sulfur Dioxide
SPP	Southwest Power Pool, Inc
Successor	The Company during the time period after October 31, 2010
TC1	Trimble County Unit 1
TC2	Trimble County Unit 2
TVA	Tennessee Valley Authority
Utilities	KU and LG&E
VDT	Value Delivery Team Process
Virginia Commission	Virginia State Corporation Commission

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## Forward-Looking Information

KU uses forward-looking statements in this annual report. Statements that are not historical facts are forward-looking statements, and are based on beliefs and assumptions of management, and on information currently available to management. Forward-looking statements include statements preceded by, followed by or using such words as “believe,” “expect,” “anticipate,” “plan,” “estimate” or similar expressions. Such statements speak only as of the date they are made, and the Company undertakes no obligation to update publicly any of them in light of new information or future events. Actual results may materially differ from those implied by forward-looking statements due to known and unknown risks and uncertainties. Factors that could cause actual results to differ materially from those indicated in any forward-looking statement include, but are not limited to:

- fuel supply availability;
- weather conditions affecting generation production, customer energy use and operating costs;
- operation, availability and operating costs of existing generation facilities;
- transmission and distribution system conditions and operating costs;
- collective labor bargaining negotiations;
- the outcome of litigation against the Company;
- potential effects of threatened or actual terrorism or war or other hostilities;
- commitments and liabilities;
- market demand and prices for energy, capacity, transmission services, emission allowances and delivered fuel;
- competition in retail and wholesale power markets;
- liquidity of wholesale power markets;
- defaults by counterparties under the Company’s energy, fuel or other power product contracts;
- market prices of commodity inputs for ongoing capital expenditures;
- capital market conditions, including the availability of capital or credit, changes in interest rates, and decisions regarding capital structure;
- the fair value of debt and equity securities and the impact on defined benefit costs and resultant cash funding requirements for defined benefit plans;
- interest rates and their effect on pension and retiree medical liabilities;
- volatility in or the impact of other changes in financial or commodity markets and economic conditions;
- profitability and liquidity, including access to capital markets and credit facilities;
- new accounting requirements or new interpretations or applications of existing requirements;
- securities and credit ratings;
- current and future environmental conditions and requirements and the related costs of compliance, including environmental capital expenditures, emission allowance costs and other expenses;
- political, regulatory or economic conditions in states, regions or countries where the Company conducts business;
- receipt of necessary governmental permits, approvals and rate relief;
- new state or federal legislation, including new tax, environmental, health care or pension-related legislation;
- state or federal regulatory developments;
- the impact of any state or federal investigations applicable to the Company and the energy industry;
- the effect of any business or industry restructuring;
- development of new projects, markets and technologies;

- performance of new ventures; and
- asset acquisitions and dispositions.

In light of these risks and uncertainties, the events described in the forward-looking statements might not occur or might occur to a different extent or at a different time than the Company has described. For additional details regarding these and other risks and uncertainties, see Risk Factors.



## Business

### General

KU, incorporated in Kentucky in 1912 and in Virginia in 1991, is a regulated utility engaged in the generation, transmission, distribution and sale of electric energy in Kentucky, Virginia and Tennessee. KU provides electric service to approximately 514,000 customers in 77 counties in central, southeastern and western Kentucky, to approximately 30,000 customers in five counties in southwestern Virginia and less than ten customers in Tennessee. KU's service area covers approximately 6,600 noncontiguous square miles. Approximately 98% of the electricity generated by KU is produced by its coal-fired electric generating stations. The remainder is generated by natural gas and oil fueled CTs and a hydroelectric power plant. In Virginia, KU operates under the name Old Dominion Power Company. KU also sells wholesale electric energy to 12 municipalities.

On November 1, 2010, KU became an indirect wholly owned subsidiary of PPL, when PPL acquired all of the outstanding limited liability company interests in the Company's direct parent, LKE, from E.ON US Investments Corp. LKE, a Kentucky limited liability company, also owns the affiliate, LG&E, a regulated utility engaged in the generation, transmission, distribution and sale of electric energy and distribution and sale of natural gas in Kentucky. Following the acquisition, the Company's business has not changed. KU and LG&E are continuing as subsidiaries of LKE, which is now an intermediary holding company in the PPL group of companies.

Headquartered in Allentown, Pennsylvania, PPL is an energy and utility holding company that was incorporated in 1994. Through its subsidiaries, PPL owns or controls about 19,000 megawatts of generating capacity in the U.S., sells energy in key U.S. markets and delivers electricity and natural gas to about 5.3 million customers in the U.S. and the U.K.

### *Predecessor and Successor*

KU's historical financial results are presented using "Predecessor" or "Successor" to designate the periods before or after PPL's acquisition of LKE. Predecessor covers the time period prior to November 1, 2010. Successor covers the time period after October 31, 2010. Certain accounting and presentation methods were changed to acceptable alternatives to conform to PPL accounting policies and the cost basis of certain assets and liabilities were changed as of November 1, 2010, as a result of the application of push-down accounting. Consequently, the financial position, results of operations and cash flows for the Successor period are not comparable to the Predecessor period.

Despite the separate presentation, the core operations of the Company have not changed. See Note 1, *Summary of Significant Accounting Policies*, for the major differences in Predecessor and Successor accounting policies. See Note 2, *Acquisition by PPL*, for information regarding the acquisition and the purchase accounting adjustments.

### Operations

*Dollars are in millions unless otherwise noted.*

The sources of operating revenues and volumes of sales for the following periods in 2010, 2009 and 2008 were as follows:

	Successor		Predecessor					
	November 1, 2010 through December 31, 2010		January 1, 2010 through October 31, 2010		Year Ended December 31, 2009		Year Ended December 31, 2008	
	Revenues		Revenues		Revenues		Revenues	
		Volumes (Gwh)		Volumes (Gwh)		Volumes (Gwh)		Volumes (Gwh)
Residential	\$ 106	1,394	\$ 440	5,788	\$ 480	6,594	\$ 462	6,803
Industrial and commercial	117	1,876	588	9,152	637	10,171	636	10,709
Municipals	15	326	88	1,676	91	1,848	92	1,971
Other retail	20	273	114	1,453	118	1,647	108	1,707
Wholesale	5	68	18	376	29	660	107	2,894
	<u>\$ 263</u>	<u>3,937</u>	<u>\$ 1,248</u>	<u>18,445</u>	<u>\$ 1,355</u>	<u>20,920</u>	<u>\$ 1,405</u>	<u>24,084</u>

KU's peak load in 2010 was 4,517 Mw on December 15, 2010, when the temperature dropped to a low of 3 degrees Fahrenheit in Lexington. KU's all time peak load was 4,640 Mw and occurred on January 16, 2009, when the temperature dropped to a low of -2 degrees Fahrenheit in Lexington.

The Company's power generating system includes coal-fired steam generating stations, with natural gas and oil fueled CTs which supplement the system during peak or emergency periods. As of December 31, 2010, KU's system capacity was:

Fuel/Plant	Total Summer Mw Capacity (a)	% Ownership	Ownership or Lease Interest in Mw	Location
<b>Coal (steam)</b>				
Ghent	1,918	100.00	1,918	Carroll County, KY
E.W. Brown	684	100.00	684	Mercer County, KY
Green River	163	100.00	163	Muhlenberg County, KY
Tyrone	71	100.00	71	Woodford County, KY
OVEC - Clifty Creek (b)	1,304	2.50	33	Jefferson County, IN
OVEC - Kyger Creek (b)	<u>1,086</u>	<u>2.50</u>	<u>27</u>	Gallia County, OH
Total steam	5,226		2,896	
<b>Natural gas/oil (combustion turbines)</b>				
E.W. Brown Units 8-11	480	100.00	480	Mercer County, KY
Trimble County Units 7-10 (c)	640	63.00	403	Trimble County, KY
Trimble County Units 5-6 (c)	320	71.00	227	Trimble County, KY
E.W. Brown Units 6-7 (c)	338	62.00	214	Mercer County, KY
Paddy's Run (c)	158	47.00	74	Jefferson County, KY
E.W. Brown Unit 5	129	47.00	63	Mercer County, KY
Haefling	<u>36</u>	<u>100.00</u>	<u>36</u>	Fayette County, KY
Total combustion turbines	2,101		1,497	

Fuel/Plant	Total Summer Mw Capacity (a)	% Ownership	Ownership or Lease Interest in Mw	Location
Hydro				
Dix Dam Hydroelectric Station	24	100.00	24	Mercer County, KY
Total hydro	24		24	
Total system capacity	<u>7,351</u>		<u>4,417</u>	

- (a) The capacity of generation units is based on a number of factors, including the operating experience and physical conditions of the units and may be revised periodically to reflect changed circumstances.
- (b) KU is contractually entitled to 2.50% of OVEC's output based on a power purchase agreement which is comprised of annual minimum debt service payments, as well as contractually-required reimbursement of plant operating, maintenance and other expenses. OVEC's capacity is shown at unit nameplate ratings.
- (c) Units are jointly owned with LG&E. See Note 14, Jointly Owned Electric Utility Plant, for further information.

With limited exceptions the Company took care, custody and control of TC2 on January 22, 2011, and has dispatched the unit to meet customer demand since that date. KU and the contractor agreed to a further amendment of the construction agreement whereby the contractor will complete certain actions relating to identifying and completing any necessary modifications to allow operation of TC2 on all fuels in accordance with initial specifications prior to certain dates, and amending the provisions relating to liquidated damages. Unit 2 is coal-fired and has a capacity of 760 Mw, of which KU's share is 462 Mw.

On December 31, 2010, KU's transmission system included 132 substations (54 of which are shared with the distribution system) with transformer capacity of approximately 13,136 MVA and approximately 4,076 miles of lines. The distribution system included 480 substations (54 of which are shared with the transmission system) with transformer capacity of approximately 7,044 MVA, and approximately 14,123 miles of overhead lines and 2,221 miles of underground conduit.

KU had a power supply contract with OMU that was terminated by OMU in May 2010. KU owns 20% of EEI's common stock and 2.5% of OVEC's common stock. KU has power purchase rights for its portion of OVEC's output. Additional information regarding this relationship is provided in Note 1, Summary of Significant Accounting Policies and Note 13, Commitments and Contingencies.

KU contracts with the TVA to act as KU's transmission reliability coordinator and SPP to function as KU's independent transmission operator, pursuant to FERC requirements. The TVA and SPP contracts provide services through August 31, 2011 and August 31, 2012, respectively. See Note 3, Rates and Regulatory Matters, for further information.

KU and LG&E jointly dispatch their generation units with the lowest cost generation used to serve their retail native load. When LG&E has excess generation capacity after serving its own retail native load and its generation cost is lower than that of KU, KU purchases electricity from LG&E. When KU has

excess generation capacity after serving its own retail native load and its generation cost is lower than that of LG&E, LG&E purchases electricity from KU. These transactions are recorded as intercompany wholesale sales and purchases and are recorded by each company at a price equal to the seller's fuel cost. Savings realized from purchasing electricity intercompany instead of generating from their own higher costs units or purchasing from the market are shared equally between the Utilities. The volume of energy each company has to sell to the other is dependent on its native load needs and its available generation.

Substantially all of KU's real and tangible property located in Kentucky is subject to a mortgage lien, securing its first mortgage bonds. See Note 11, Long-Term Debt, for further information.

### Rates and Regulations

PPL, KU's ultimate parent, is a holding company under PUHCA 2005. PPL, its utility subsidiaries, including KU, and certain of its non-utility subsidiaries are subject to extensive regulation by the FERC with respect to numerous matters, including: electric utility facilities and operations, wholesale sales of power and related transactions, accounting practices, issuances and sales of securities, acquisitions and sales of utility properties, payments of dividends out of capital and surplus, financial matters and inter-system sales of non-power goods and services. KU believes that it has adequate authority (including financing authority) under existing FERC Orders and regulations to conduct its business and will seek additional authorization when necessary.

The Company is subject to the jurisdiction of the FERC, Kentucky Commission, Virginia Commission and the Tennessee Regulatory Authority in virtually all matters related to electric utility regulation, and as such, its accounting is subject to the regulated operations guidance of the FASB ASC. Given its competitive position in the marketplace and the status of regulation in Kentucky, Virginia and Tennessee there are no plans or intentions to discontinue the application of the regulated operations guidance of the FASB ASC.

On April 28, 2010, E.ON U.S. announced that a Purchase and Sale Agreement (the "Agreement") had been entered into among E.ON US Investments Corp., PPL and E.ON.

The transaction was subject to customary closing conditions, including the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Act, receipt of required regulatory approvals (including the FERC and state regulators in Kentucky, Virginia and Tennessee) and the absence of injunctions or restraints imposed by governmental entities.

Change of control and financing-related applications were filed on May 28, 2010, with the Kentucky Commission and on June 15, 2010, with the Virginia Commission and the Tennessee Regulatory Authority. An application with the FERC was filed on June 28, 2010. During the second quarter of 2010, a number of parties were granted intervenor status in the Kentucky Commission proceedings and data request filings and responses occurred. Early termination of the Hart-Scott-Rodino waiting period was received on August 2, 2010.

A hearing in the Kentucky Commission proceedings was held on September 8, 2010, at which time a unanimous settlement agreement was presented. In the settlement, KU committed that no base rate increases would take effect before January 1, 2013. The KU rate increases that took effect on August 1,

2010, were not impacted by the settlement. Under the terms of the settlement, KU retains the right to seek approval for the deferral of “extraordinary and uncontrollable costs.” Interim rate adjustments will continue to be permissible during that period for existing fuel, environmental and demand-side management cost trackers. The agreement also substitutes an acquisition savings shared deferral mechanism for the requirement that the Company file a synergies plan with the Kentucky Commission. This mechanism, which will be in place until the earlier of five years or the first day of the year in which a base rate increase becomes effective, permits KU to earn up to a 10.75% return on equity. Any earnings above a 10.75% return on equity will be shared with customers on a 50%/50% basis. On September 30, 2010, the Kentucky Commission issued an Order approving the transfer of ownership of KU via the acquisition of E.ON U.S. by PPL, incorporating the terms of the submitted settlement. On October 19, 2010 and October 21, 2010, respectively, Orders approving the acquisition of E.ON U.S. by PPL were received from the Virginia Commission and the Tennessee Regulatory Authority. The Commissions’ Orders contained a number of other commitments with regard to operations, workforce, community involvement and other matters.

In mid-September 2010, KU and other applicants in the FERC change of control proceeding reached an agreement with the protesters, whereby such protests have been withdrawn. The agreement, which was filed for consideration with the FERC, includes various conditional commitments, such as a continuation of certain existing undertakings with protesters in prior cases, an agreement not to terminate certain KU municipal customer contracts prior to January 2017, an exclusion of any transaction-related costs from wholesale energy and tariff customer rates to the extent that KU agreed not to seek the same transaction-related cost from retail customers and agreements to coordinate with protesters in certain open or ongoing matters. A FERC Order approving the transaction was received on October 26, 2010, and the transaction was completed on November 1, 2010.

In January 2010, KU filed an application with the Kentucky Commission requesting an increase in electric base rates of approximately 12%, or \$135 million annually. In June 2010, KU and all of the intervenors, except the AG, agreed to a stipulation providing for an increase in electric base rates of \$98 million annually and filed a request with the Kentucky Commission to approve such settlement. An Order in the proceeding was issued in July 2010, approving all the provisions in the stipulation, including a return on equity range of 9.75-10.75%. The new rates became effective on August 1, 2010.

In June 2009, KU filed an application with the Virginia Commission requesting an increase in electric base rates for its Virginia jurisdictional customers in an amount of \$12 million annually or approximately 21%. The proposed increase reflected a proposed rate of return on rate base of 8.586% based on a return on equity of 12%. As permitted, pursuant to a Virginia Commission Order, KU elected to implement the proposed rates effective November 1, 2009, on an interim basis. During December 2009, KU and the Virginia Commission Staff agreed to a Stipulation and Recommendation authorizing a base rate revenue increase of \$11 million annually and a return on rate base of 7.846% based on a 10.5% return on common equity. In March 2010, the Virginia Commission issued an Order approving the stipulation, with the increased rates to be put into effect as of April 1, 2010. As part of the stipulation, KU refunded approximately \$1 million in interim rate amounts in excess of the ultimate approved rates.

In January 2009, a significant ice storm passed through KU’s service area causing approximately 199,000 customer outages, followed closely by a severe wind storm in February 2009 causing approximately 44,000 customer outages. The Company filed an application with the Kentucky Commission in April 2009, requesting approval to establish a regulatory asset and defer for future

recovery approximately \$62 million in incremental operation and maintenance expenses related to the storm restoration. In September 2009, the Kentucky Commission issued an Order allowing the Company to establish a regulatory asset of up to \$62 million based on its actual costs for storm damages and service restoration due to the January and February 2009 storms. In September 2009, the Company established a regulatory asset of \$57 million for actual costs incurred. KU received approval in its 2010 base rate case to recover this asset over a ten year period with recovery beginning August 1, 2010.

In September 2008, high winds from the remnants of Hurricane Ike passed through the service area causing significant outages and system damage. In October 2008, KU filed an application with the Kentucky Commission requesting approval to establish a regulatory asset and defer for future recovery approximately \$3 million of expenses related to the storm restoration. In December 2008, the Kentucky Commission issued an Order allowing the Company to establish a regulatory asset of up to \$3 million based on its actual costs for storm damages and service restoration due to Hurricane Ike. In December 2008, the Company established a regulatory asset of \$2 million for actual costs incurred. The Company received approval in its 2010 base rate case to recover this asset over a ten year period beginning August 1, 2010.

In September 2008, KU filed an application with the FERC for increases in electric base rates applicable to wholesale power sales contracts or interchange agreements involving, collectively, twelve Kentucky municipalities. The application requested a shift from an all-in stated unit charge rates to an unbundled formula rate, including an annual adjustment mechanism. In May 2009, the FERC issued an Order approving a settlement among the parties in the case, incorporating increases of approximately 3% from prior rates and a return on equity of 11%. In May 2010, KU submitted to the FERC the proposed current annual adjustments to the formula rates, which incorporated certain proposed increases. Updated rates, including certain further adjustments from a review process involving wholesale requirements customers, became effective as of July 1, 2010.

By mutual agreement, the parties' settlement of the 2008 application left outstanding the issue of whether KU must allocate to the municipal customers a portion of renewable resources it may be required to procure on behalf of its retail ratepayers. An Order was issued by the FERC in July 2010, indicating that KU is not required to allocate a portion of any renewable resources to the twelve municipalities, thus resolving the remaining issue.

In July 2008, KU filed an application with the Kentucky Commission requesting an increase in electric base rates. In January 2009, KU, the AG, the KIUC and all other parties to the rate case filed a settlement agreement with the Kentucky Commission, under which KU's electric base rates decreased by \$9 million annually. An Order approving the settlement agreement was received in February 2009. The new rates were implemented effective February 6, 2009.

For a further discussion of regulatory matters, see Note 3, Rates and Regulatory Matters.

### Coal Supply

Coal-fired generating units provided approximately 98% of KU's net kWh generation for 2010. The remaining net generation was provided by natural gas and oil fueled CTs and a hydroelectric plant. Coal is expected to be the predominant fuel used by KU in the foreseeable future, with natural gas and oil

being used for peaking capacity and flame stabilization in coal-fired boilers or in emergencies. The Company has no nuclear generating units and has no plans to build any in the foreseeable future.

Fuel inventory is maintained at levels estimated to be necessary to avoid operational disruptions at the coal-fired generating units. Reliability of coal deliveries can be affected periodically by a number of factors including fluctuations in demand, coal mine production issues and other supplier or transporter operating difficulties.

KU has entered into coal supply agreements with various suppliers for coal deliveries for 2011 and beyond and normally augments its coal supply agreements with spot market purchases. The Company has a coal inventory policy which it believes provides adequate protection under most contingencies.

KU expects to continue purchasing most of its coal, which has sulfur content in the 0.7% - 3.5% range, from western and eastern Kentucky, West Virginia, southern Indiana, southern Illinois, Ohio and Wyoming for the foreseeable future. This supply, in combination with the installation of FGDs (SO<sub>2</sub> removal systems), KU expects its use of higher sulfur coal to increase, the combination of which is expected to enable KU to continue to provide electric service in compliance with existing environmental laws and regulations. Coal is delivered to KU's generating stations by a mix of transportation modes, including barge, truck and rail.

#### Seasonality

Demand for and market prices for electricity are affected by weather. As a result, KU's overall operating results in the future may fluctuate substantially on a seasonal basis, especially when more severe weather conditions such as heat waves or winter storms make such fluctuations more pronounced. The pattern of this fluctuation may change depending on the type and location of the facilities KU owns and the terms of its contracts to purchase or sell electricity.

#### Environmental Matters

##### *General*

Protection of the environment is a major priority for KU and a significant element of its business activities. KU's properties and operations are subject to extensive environmental-related oversight by federal, state and local regulatory agencies, including via air quality, water quality, waste management and similar laws and regulations. Therefore, KU must conduct its operations in accordance with numerous permit and other requirements issued under or contained in such laws or regulations.

##### *Climate Change*

Recent developments continue to indicate an increased possibility of significant climate change or GHG legislation or regulation, at the international, federal, regional and state levels. During December 2009, as part of the United Nation's Copenhagen Accord, the United States agreed to a non-binding goal to reduce GHG emissions to 17% below 2005 levels by 2020. Additionally, during 2009, the U.S. House of Representatives passed comprehensive GHG legislation, which included a number of measures to limit GHG emissions and achieve GHG emission reduction targets below 2005 levels of 3% by 2012, 17% by 2020 and 83% by 2050. Similar legislation has been considered in the U.S. Senate, but the prospects for

passage remain uncertain. In late 2009, the EPA issued a final endangerment finding relating to mobile sources of GHGs and a GHG reporting requirement beginning in 2010. In 2010, the EPA issued a final rule requiring implementation of best available control technology for GHG emissions from new or modified power plants, effective January 2011. In December 2010, the EPA announced that it intends to propose New Source Performance Standards addressing GHG emissions from new and existing power plants, with a proposed rule expected in July 2011. Finally, a number of U.S. states, although not currently including Kentucky, have adopted GHG-reduction legislation or regulation of various sorts. The developing GHG initiatives include a number of differing structures and formats, including direct limitations on GHG sources, issuance of allowances for GHG emissions, cap-and-trade programs for such allowances, renewable or alternative generation portfolio standards and mechanisms relating to demand reduction, energy efficiency, smart-grid, transmission expansion, carbon-sequestration or other GHG-reducing efforts. While the final terms and impacts of such initiatives cannot be estimated, KU, as a primarily coal-fired utility, could be highly affected by such proceedings.

Among other emissions, GHGs include carbon-dioxide, which is produced via the combustion of fossil fuels such as coal and natural gas. KU's generating fleet is approximately 66% coal-fired, 34% oil/natural gas-fired and less than 1% hydroelectric based on capacity. During 2010, KU produced approximately 98% of its electricity from coal, 2% from natural gas combustion and less than 1% from hydroelectric generation, based on Mwh. During 2010, KU's emissions of GHGs were approximately 16.4 million metric tons of carbon-dioxide equivalents from KU's owned or controlled generation sources. While its generation activities account for the bulk of its GHG emissions, other GHG sources at KU include operation of motor vehicles and powered equipment, leakage or evaporation associated with natural gas pipelines, refrigerating equipment and similar activities.

Ultimately, environmental matters or potential environmental matters can represent an important element of current or future potential capital requirements, future unit retirement or replacement decisions, supply and demand for electricity, operating and maintenance expenses or compliance risks for the Company. Based on prior regulatory precedent, KU currently anticipates that many of such direct costs may be recoverable through rates or other regulatory mechanisms, particularly with respect to coal-related generation, but the availability, timing or completeness of such rate recovery cannot be assured. Ultimately, climate change and other environmental matters will likely increase the level of capital expenditures and operating and maintenance costs incurred by the Company during the next several years. With respect to NAAQS, CATR, CAMR replacement and coal combustion byproducts developments, based on a preliminary analysis of proposed regulations, the Company may be required to consider actions such as upgrading existing emissions controls, installing additional emissions controls, upgrading byproducts disposal and storage and possible early replacement of coal-fired units. In order to comply with the coal combustion residual rules and the above referenced air rules, capital expenditures for KU are preliminarily estimated to be in the \$1.5 to \$1.7 billion range over the next ten years, although final costs may substantially vary. This estimate does not include compliance with GHG rules or contemplated water-related environmental changes. See Risk Factors, Management's Discussion and Analysis and Note 13, Commitments and Contingencies, for further information.



### State Executive or Legislative Matters

In November 2008, the Commonwealth of Kentucky issued an action plan to create efficient, sustainable energy solutions and strategies and move toward state energy independence. The plan outlines the following seven strategies to work toward these goals:

- Improve the energy efficiency of Kentucky's homes, buildings, industries and transportation fleet
- Increase Kentucky's use of renewable energy
- Sustainably grow Kentucky's production of biofuels
- Develop a coal-to-liquids industry in Kentucky to replace petroleum-based liquids
- Implement a major and comprehensive effort to increase natural gas supplies, including coal-to-natural gas in Kentucky
- Initiate aggressive carbon capture/sequestration projects for coal-generated electricity in Kentucky
- Examine the use of nuclear power for electricity generation in Kentucky

In December 2009, the Governor of Kentucky's Executive Task Force on Biomass and Biofuels issued a final report to establish potential strategic actions to develop biomass and biofuels industries in Kentucky. The plan noted the potential importance of biomass as a renewable energy source available to Kentucky and discussed various goals or mechanisms, such as the use of approximately 25 million tons of biomass for generation fuel annually, allotment of electricity and natural gas taxes and state tax credits to support biomass development.

In January 2010, a state-established Kentucky Climate Action Plan Council (the "Council") commenced formal activities. The Council, which includes governmental, industry, consumer and other representatives, seeks to identify possible Kentucky responses to potential climate change and federal legislation, including increasing statewide energy efficiency, energy independence and economic growth. The Council has established various technical work groups, including in the areas of energy supply and energy efficiency/conservation, to provide input, data and recommendations.

During the current session of the Kentucky General Assembly, as during prior legislative sessions, legislators have introduced or are expected to introduce various bills with respect to environmental or utility matters, including potential requirements relating to renewable energy portfolios, energy conservation measures, coal mining or coal byproduct operations and other matters. The current session is scheduled to end in March 2011 and until such time the prospects and final terms of any such legislation cannot be determined. Legislative and regulatory actions as a result of these proposals and their impact on KU, which may be significant, cannot currently be predicted.

### Franchises and Licenses

KU provides electric delivery service in its various service areas pursuant to certain franchises, licenses, statutory service areas, easements and other rights or permissions granted by state legislatures, cities or municipalities or other entities.

## Competition

There are currently no other electric utilities operating within the electric service areas of KU. Neither the Kentucky General Assembly nor the Kentucky Commission has adopted or approved a plan or timetable for retail electric industry competition in Kentucky. The nature or timing of any legislative or regulatory actions regarding industry restructuring and their impact on KU, which may be significant, cannot currently be predicted. Virginia, formerly a competitive jurisdiction, has enacted legislation which implements a hybrid model of cost-based regulation. See Note 3, Rates and Regulatory Matters, for further information.

## Employees and Labor Relations

KU had 974 employees at December 31, 2010, consisting of 973 full-time employees and 1 part-time employee. Of the total employees, 145, or 15%, were operating, maintenance and construction employees represented by the IBEW Local 2100 and the United Steelworkers of America (“USWA”) Local 9447-01. In August 2009, the Company and its employees represented by the IBEW Local 2100 entered into a three-year collective bargaining agreement that provides for negotiated increases or changes to wages, benefits or other provisions and annual wage re-openers. In August 2008, the Company and its employees represented by the USWA Local 9447-01 entered into a three-year collective bargaining agreement that provides for negotiated increases or changes to wages, benefits or other provisions and annual wage re-openers.

### Officers of the Company

Officers are elected annually by the Board of Directors. There are no family relationships among any of the executive officers, nor is there any arrangement or understanding between any executive officer and any other person pursuant to which the officer was selected.

Except as may be set forth in Legal Proceedings, there have been no events under any bankruptcy act, no criminal proceedings and no judgments or injunctions material to the evaluation of the ability and integrity of any executive officer during the past five years.

Listed below are the executive officers at December 31, 2010.

Name	Age	Positions Held During the Past Five Years	Dates
Victor A. Staffieri	55	Chairman of the Board, President and Chief Executive Officer	May 2001 – present
John R. McCall	67	Executive Vice President, General Counsel, Corporate Secretary and Chief Compliance Officer	July 1994 – present
Chris Hermann	63	Senior Vice President – Energy Delivery	February 2003 – present
Paula H. Pottinger	53	Senior Vice President – Human Resources	January 2006 – present
S. Bradford Rives	52	Chief Financial Officer	September 2003 – present
Paul W. Thompson	53	Senior Vice President – Energy Services	June 2000 – present

Officers generally serve in the same capacities at the Company, LKE and LG&E.

## **Risk Factors**

*Any of the events or circumstances described as risks below could result in a significant or material adverse effect on the business, results of operations, cash flows or financial condition. The risks and uncertainties described below may not be the only risks and uncertainties that KU faces. Additional risks and uncertainties not currently known or that KU currently deems immaterial may also result in a significant or material adverse effect on the business, results of operations, cash flow or financial condition.*

### **KU's business is subject to significant and complex governmental regulation.**

Various federal and state entities, including but not limited to the FERC, Kentucky Commission, Virginia Commission and the Tennessee Regulatory Authority, regulate many aspects of utility operations of KU, including the following:

- the rates that KU may charge and the terms and conditions of the Company's service and operations;
- financial and capital structure matters;
- siting and construction of facilities;
- mandatory reliability and safety standards and other standards of conduct;
- accounting, depreciation and cost allocation methodologies;
- tax matters;
- affiliate restrictions;
- acquisition and disposal of utility assets and securities; and
- various other matters.

Such regulations or changes thereto may subject KU to higher operating costs or increased capital expenditures and failure to comply could result in sanctions or possible penalties. In any rate-setting proceedings, federal or state agencies, intervenors and other permitted parties may challenge rate requests and ultimately reduce, alter or limit the rates the Company seeks.

The profitability of KU is highly dependent on its ability to recover the costs of providing energy and utility services to its customers and earn an adequate return on its capital investments. KU currently provides services to retail customers at rates approved by one or more federal or state regulatory commissions, including those commissions referred to above. While these rates are generally regulated based on an analysis of their costs incurred in a base year, the rates KU is allowed to charge may or may not match its costs at any given time. While rate regulation is premised on providing a reasonable opportunity to earn a reasonable rate of return on invested capital, there can be no assurance that the applicable regulatory commissions will consider all of the costs to have been prudently incurred or that the regulatory process in which rates are determined will always result in rates that will produce full recovery of KU's costs or an adequate return on KU's capital investments. If the Company's costs are not adequately recovered through rates, it could have an adverse affect on the business, results of operations, cash flows or financial condition.

As part of the PPL acquisition commitments, KU has agreed, subject to certain limited exceptions such as fuel and environmental cost recoveries, that no base rate increase would take effect for Kentucky retail customers before January 1, 2013.

**Transmission and interstate market activities of KU, as well as other aspects of the business, are subject to significant FERC regulation.**

KU is subject to extensive regulation by the FERC covering matters including rates charged to transmission users, market-based or cost-based rates applicable to wholesale customers; interstate power market structure; construction and operation of transmission facilities; mandatory reliability standards; standards of conduct and affiliate restrictions and other matters. Existing FERC regulation, changes thereto or issuances of new rules or situations of non-compliance, including but not limited to the areas of market-based tariff authority, RSG resettlements in the MISO market, mandatory reliability standards and natural gas transportation regulation can affect the earnings, operations or other activities of KU.

**Changes in transmission and wholesale power market structures could increase costs or reduce revenues.**

Wholesale sales fluctuate with regional demand, fuel prices and contracted capacity. Changes to transmission and wholesale power market structures and prices may occur in the future, are not estimable and may result in unforeseen effects on energy purchases and sales, transmission and related costs or revenues. These can include commercial or regulatory changes affecting power pools, exchanges or markets in which KU participates.

**KU undertakes significant capital projects and these activities are subject to unforeseen costs, delays or failures, as well as risk of inadequate recovery of resulting costs.**

KU's business is capital intensive and requires significant investments in energy generation and distribution and other infrastructure projects, such as projects for environmental compliance. The completion of these projects without delays or cost overruns is subject to risks in many areas, including the following:

- approval, licensing and permitting;
- land acquisition and the availability of suitable land;
- skilled labor or equipment shortages;
- construction problems or delays, including disputes with third party intervenors; increases in commodity prices or labor rates;
- contractor performance;
- environmental considerations and regulations;
- weather and geological issues; and
- political, labor and regulatory developments.

Failure to complete capital projects on schedule or on budget, or at all, could adversely affect the Company's financial performance, operations and future growth.

**The costs of compliance with, and liabilities under, environmental laws are significant and are subject to continual changes.**

Extensive federal, state and local environmental laws and regulations are applicable to KU's air emissions, water discharges and the management of hazardous and solid waste, among other areas; and

the costs of compliance or alleged non-compliance cannot be predicted with certainty but could be material. In addition, KU's costs may increase significantly if the requirements or scope of environmental laws or regulations, or similar rules, are expanded or changed from prior versions by the relevant agencies. Costs may take the form of increased capital or operating and maintenance expenses; monetary fines, penalties or forfeitures or other restrictions. Many of these environmental law considerations are also applicable to the operations of key suppliers, or customers, such as coal producers, industrial power users, etc., and may impact the costs of their products or their demand for KU's services.

**KU is subject to operational and financial risks regarding certain on-going developments concerning environmental regulation.**

A number of regulatory initiatives have been implemented or are under development which could have the effect of significantly increasing the environmental regulation or operational or compliance costs related to a number of emissions or operating activities which are associated with the combustion of coal as occurs at the Company's generating stations. Such developments could include potential new or revised federal or state legislation or regulation regarding emissions of NO<sub>x</sub>, SO<sub>2</sub>, mercury and other particulates generally and regarding storage of coal combustion byproducts. Additional regulatory initiatives may occur in other areas involving the Company's operations, including revision of limitations on water discharge or intake activities or increased standards relating to polychlorinated biphenyl usage. Compliance with any new laws or regulations in these matters could result in significant changes to KU's operations, significant capital expenditures by the Company or significant increases in the cost of conducting business.

**Operating results are affected by weather conditions, including storms and seasonal temperature variations, as well as by significant man-made or accidental disturbances, including terrorism or natural disasters.**

These weather or other factors can significantly affect the finances or operations of KU by changing demand levels; causing outages; damaging infrastructure or requiring significant repair costs; affecting capital markets and general economic conditions or impacting future growth.

**KU is subject to operational and financial risks regarding potential developments concerning global climate change.**

Various regulatory and industry initiatives have been implemented or are under development to regulate or otherwise reduce emissions of GHGs, which are emitted from the combustion of fossil fuels such as coal and natural gas, as occurs at the Company's generating stations. Such developments could include potential federal or state legislation or industry initiatives allocating or limiting GHG emissions; establishing costs or charges on GHG emissions or on fuels relating to such emissions; requiring GHG capture and sequestration; establishing renewable portfolio standards or generation fleet-diversification requirements to address GHG emissions; promoting energy efficiency and conservation; changes in transmission grid construction, operation or pricing to accommodate GHG-related initiatives; or other measures. The generation fleet of KU is predominantly coal-fired and may be highly impacted by developments in this area. Compliance with any new laws or regulations regarding the reduction of GHG emissions could result in significant changes to KU's operations, significant capital expenditures by the Company and a significant increase in the cost of conducting business. KU may face strong

competition for, or difficulty in obtaining, required GHG-compliance related goods and services, including construction services, emissions allowances and financing, insurance and other inputs relating thereto. Increases in KU's costs or prices of producing or selling electric power due to GHG-related developments could materially reduce or otherwise affect the demand, revenue or margin levels applicable to its power, thus adversely affecting its financial condition or results of operations.

**KU is subject to physical, market and economic risks relating to potential effects of climate change.**

Climate change may produce changes in weather or other environmental conditions, including temperature or precipitation changes, such as warming or drought. These changes may affect farm and agriculturally-dependent businesses and activities, which are an important part of Kentucky's economy, and thus may impact consumer demand for electric power. Temperature increases could result in increased overall electricity volumes or peaks and precipitation changes could result in altered availability of water for plant cooling operations. These or other meteorological changes could lead to increased operating costs, capital expenses or power purchase costs by KU. Conversely, climate change could have a number of potential impacts tending to reduce demand. Changes may entail more frequent or more intense storm activity, which, if severe, could temporarily disrupt regional economic conditions and adversely affect electricity demand levels. As discussed in other risk factors, storm outages and damage often directly decrease revenues or increase expenses, due to reduced usage and higher restoration charges, respectively. GHG regulation could increase the cost of electric power, particularly power generated by fossil fuels, and such increases could have a depressive effect on the regional economy. Reduced economic and consumer activity in the service area of KU, both in general and specific to certain industries and consumers accustomed to previously low-cost power, could reduce demand for KU's electricity. Also, demand for services could be similarly lowered should consumers' preferences or market factors move toward favoring energy efficiency, low-carbon power sources or reduced electric usage generally.

**The business of KU is subject to risks associated with local, national and worldwide economic conditions.**

The consequences of prolonged recessionary conditions may include a lower level of economic activity and uncertainty or volatility regarding energy prices and the capital and commodity markets. A lower level of economic activity might result in a decline in energy consumption, unfavorable changes in energy and commodity prices and slower customer growth, which may adversely affect KU's future revenues and growth. Instability in the financial markets, as a result of recession or otherwise, also may affect the cost of capital and the ability to raise capital. A deterioration of economic conditions may lead to decreased production by KU's industrial customers and, therefore, lower consumption of electricity. Decreased economic activity may also lead to fewer commercial and industrial customers and increased unemployment, which may in turn impact residential customers' ability to pay. Further, worldwide economic activity has an impact on the demand for basic commodities needed for utility infrastructure. Changes in global demand may impact the ability to acquire sufficient supplies and the cost of those commodities may be higher than expected.

**KU's business is concentrated in the Midwest United States, specifically Kentucky and Virginia.**

Although the business of KU is concentrated in Kentucky and Virginia, it also operates in Tennessee. Local and regional economic conditions, such as population growth, industrial growth, expansion and economic development or employment levels, as well as the operational or financial performance of major industries or customers, can affect the demand for energy and KU's results of operations. Significant industries and activities in the service area of KU include aluminum and steel smelting and fabrication; chemical processing; coal, mineral and ceramic related activities; educational institutions; health care facilities; paper and pulp processing; metal fabrication; and water and sewer utilities. Any significant downturn in these industries or activities or in local and regional economic conditions in KU's service area may adversely affect the demand for electricity in the service area.

**KU is subject to operational risks relating to KU's generating plants, transmission facilities, distribution equipment, information technology systems and other assets and activities.**

Operation of power plants, transmission and distribution facilities, information technology systems and other assets and activities subjects KU to many risks, including the breakdown or failure of equipment; accidents; security breaches, viruses or outages affecting information technology systems; labor disputes; obsolescence; delivery/transportation problems and disruptions of fuel supply and performance below expected levels. Occurrences of these events may impact the ability of KU to conduct its business efficiently or lead to increased costs, expenses or losses.

Although KU maintains customary insurance coverage for certain of these risks common to utilities, it does not have insurance covering the transmission and distribution systems, other than substations, because it has found the cost of such insurance to be prohibitive. If KU is unable to recover the costs incurred in restoring transmission and distribution properties following damage resulting from ice storms, tornados or other natural disasters or to recover the costs of other liabilities arising from the risks of its business, through a change in rates or otherwise, or if such recovery is not received on a timely basis, it may not be able to restore losses or damages to its properties without an adverse effect on its financial condition, results of operations or its reputation.

**KU is subject to liability risks relating to its generation, transmission, distribution and retail businesses.**

The conduct of the physical and commercial operations of KU subjects it to many risks, including risks of potential physical injury, property damage or other financial affects, caused to or caused by employees, customers, contractors, vendors, contractual or financial counterparties and other third parties.

**KU could be negatively affected by rising interest rates, downgrades to bond credit ratings or other negative developments in its ability to access capital markets.**

In the ordinary course of business, KU is reliant upon adequate long-term and short-term financing means to fund significant capital expenditures, debt interest or maturities and operating needs. As a capital-intensive business, the Company is sensitive to developments in interest rate levels; credit rating considerations; insurance, security or collateral requirements; market liquidity and credit availability and



refinancing steps necessary or advisable to respond to credit market changes. Changes in these conditions could result in increased costs and decreased liquidity available to the Company.

**KU is subject to commodity price risk, credit risk, counterparty risk and other risks associated with the energy business.**

General market or pricing developments or failures by counterparties to perform their obligations relating to energy, fuels, other commodities, goods, services or payments could result in potential increased costs to the Company.

**KU is subject to risks associated with defined benefit retirement plans, health care plans, wages and other employee-related matters.**

KU sponsors pension and postretirement benefit plans for its employees. Risks with respect to these plans include adverse developments in legislation or regulation, future costs or funding levels, returns on investments, market fluctuations, interest rates and actuarial matters. Changes in health care rules, market practices or cost structures can affect current or future funding requirements or liabilities. Without sustained growth in respective investments over time to increase the value of plan assets, KU could be required to fund plans with significant amounts of cash. KU is also subject to risks related to changing wage levels, whether related to collective bargaining agreements or employment market conditions, ability to attract and retain key personnel and changing costs of providing health care benefits.

**KU is subject to risks associated with federal and state tax regulations.**

Changes in taxation as well as the inherent difficulty in quantifying potential tax effects of business decisions could negatively impact results of operations. KU is required to make judgments in order to estimate its obligations to taxing authorities. These tax obligations include income, property, sales and use and employment-related taxes. KU also estimates its ability to utilize tax benefits and tax credits. Due to the revenue needs of the states and jurisdictions in which KU operates, various tax and fee increases may be proposed or considered. KU cannot predict whether legislation or regulation will be introduced or the effect on the Company of any such changes. If enacted, any changes could increase tax expense and could have a negative impact on its results of operations and cash flows.

## **Legal Proceedings**

### Rates and Regulatory Matters

For a discussion of current rates and regulatory matters, including recent electric base rate increase proceedings, rate commitments in change-of-control proceedings, TC2 proceedings, FERC, Kentucky Commission and Virginia Commission proceedings and other rates or regulatory matters affecting KU, see Note 3, Rates and Regulatory Matters, and Note 13, Commitments and Contingencies.

### Environmental

For a discussion of environmental matters, including potential coal combustion byproduct or ash pond regulation; additional reductions in SO<sub>2</sub>, NO<sub>x</sub> and other regulated emissions; NOV's and other emissions proceedings; environmental permit challenges; and other environmental items affecting KU, see Risk Factors, Note 3, Rates and Regulatory Matters, and Note 13, Commitments and Contingencies.

### Climate Change

For a discussion of matters relating to potential climate change, GHG emission or global warming developments, including increased legislative and regulatory activity which could limit or increase costs applicable to fossil fuel generation sources, legal proceedings claiming damages relating to global warming, GHG reporting requirements and other matters, see Business, Risk Factors, Management's Discussion and Analysis and Note 13, Commitments and Contingencies.

### Litigation

In connection with an administrative proceeding alleging a violation by a former Argentine affiliate under that country's 2002-2003 emergency currency exchange laws, claims are pending against the affiliate's then directors, including two individuals who are executive officers of the Company, in a specialized Argentine financial criminal court. Under applicable Argentine laws, directors of a local company may be liable for monetary penalties for a subject company's violations of the currency laws. The affiliate and the relevant executive officers believe their actions were in compliance with the relevant laws and have presented defenses in the administrative and criminal proceedings. LKE has standard indemnification arrangements with its executive officers. The former affiliate is now owned by a third party, which has agreed to indemnify LKE and the relevant executive officers.

For a discussion of litigation matters, see Note 13, Commitments and Contingencies.

### Other

In the normal course of business, other lawsuits, claims, environmental actions and other governmental proceedings arise against KU. To the extent that damages are assessed in any of these lawsuits, the Company believes that its insurance coverage is adequate. Management, after consultation with legal counsel, does not anticipate that liabilities arising out of currently pending or threatened lawsuits and claims will have a material adverse effect on KU's financial position or results of operations.

### Selected Financial Data

*Dollars are in millions unless otherwise noted.*

	Successor	Predecessor				
	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31,			
			2009	2008	2007	2006
Operating revenues	<u>\$ 263</u>	<u>\$ 1,248</u>	<u>\$ 1,355</u>	<u>\$ 1,405</u>	<u>\$ 1,272</u>	<u>\$ 1,210</u>
Operating income	<u>\$ 65</u>	<u>\$ 285</u>	<u>\$ 269</u>	<u>\$ 260</u>	<u>\$ 267</u>	<u>\$ 235</u>
Net income	<u>\$ 35</u>	<u>\$ 140</u>	<u>\$ 133</u>	<u>\$ 158</u>	<u>\$ 167</u>	<u>\$ 152</u>
Total assets	<u>\$ 6,059</u>	<u>\$ 5,145</u>	<u>\$ 4,956</u>	<u>\$ 4,518</u>	<u>\$ 3,796</u>	<u>\$ 3,148</u>
Long-term debt obligations (including amounts due within one year)	<u>\$ 1,841</u>	<u>\$ 1,682</u>	<u>\$ 1,682</u>	<u>\$ 1,532</u>	<u>\$ 1,264</u>	<u>\$ 843</u>

Management's Discussion and Analysis and Notes to Financial Statements should be read in conjunction with the above information.

## Management's Discussion and Analysis

*Management's Discussion and Analysis should be read in conjunction with the Financial Statements and Notes for the years ended December 31, 2010, 2009 and 2008. Dollars are in millions unless otherwise noted.*

The purpose of "Management's Discussion and Analysis" is to provide information about KU's performance in implementing its' strategies and managing risks and challenges. Specifically:

- "Overview" provides background regarding KU's business and identifies significant matters with which management is primarily concerned in evaluation of KU's financial condition and operating results.
- "Results of Operations" provides a description of KU's operating results in 2010, 2009 and 2008, including a review of earnings and a brief outlook for 2011.
- "Financial Condition" provides an analysis of KU's liquidity position and credit profile, including its sources of cash (including bank credit facilities and sources of operating cash flow) and uses of cash (including contractual obligations and capital expenditure requirements) and the key risks and uncertainties that impact KU's past and future liquidity position and financial condition. This subsection also includes a discussion of KU's current credit ratings.
- "Application of Critical Accounting Policies and Estimates" provides an overview of the accounting policies that are particularly important to the results of operations and financial condition of KU and that require its management to make significant estimates, assumptions and other judgments.

### Overview

KU is a regulated utility engaged in the generation, transmission, distribution and sale of electric energy in Kentucky, Virginia and Tennessee. See the Business section for a description of the business. The rates KU charges its customers requires approval of the appropriate regulatory government agency. See Note 3, Rates and Regulatory Matters, for information regarding rate cases, regulatory assets and liabilities and other regulatory matters.

KU and its affiliate, LG&E, are wholly owned subsidiaries of LKE, a Kentucky limited liability company. PPL acquired LKE on November 1, 2010. Headquartered in Allentown, Pennsylvania, PPL is an energy and utility holding company that was incorporated in 1994. Through its subsidiaries, PPL owns or controls about 19,000 megawatts of generating capacity in the U.S., sells energy in key U.S. markets and delivers electricity and natural gas to about 5.3 million customers in the U.S. and the U.K. Following the acquisition, both KU and LG&E continue operating as subsidiaries of LKE, which is now an intermediary holding company in the PPL group of companies. See Note 2, Acquisition by PPL, for further information regarding the acquisition.

In operating its business, the Company faces several risks including credit risks, liquidity risks, interest rate risks and commodity and price risks. For instance, the Company has credit risks from counterparties, customers and effects of its' own credit ratings. KU attempts to manage these risks through the adoption of financial and operational risk management programs that, among other things, are designed to monitor and reduce its' exposure to these risks. Identified within "Management's

Discussion and Analysis” of “Financial Condition” and “Results of Operations” are risks KU’s management currently consider material; these risks are not the only risks faced by KU. Additional risks not presently known or currently deemed immaterial may also impair KU’s business operations. See Risk Factors and Financial Condition - Risk Management for further discussion.

#### Predecessor and Successor Financial Presentation

KU’s financial statements and related financial and operating data include the periods before or after PPL’s acquisition of LKE on November 1, 2010, and are labeled as Predecessor or Successor. KU applied push-down accounting to account for the acquisition. For accounting purposes only, push-down accounting is considered to create a new entity due to new cost basis assigned to assets, liabilities and equity as of the acquisition date. Consequently, KU’s results of operations and cash flows for the Predecessor and Successor periods in 2010 are shown separately, rather than combined, in its audited financial statements.

In the “Management’s Discussion and Analysis” of “Results of Operations” and “Financial Condition”, the Company has included disclosure of the combined Predecessor and Successor results of operations and cash flows. Such presentation is considered to be a non-GAAP disclosure. KU has included such disclosure because the Company believes it facilitates the comparison of 2010 operating and financial performance to 2009 and 2008, and because the core operations of the Company have not changed as a result of the acquisition.

#### Competition

See the Business section for information concerning competition.

#### Environmental Matters

##### *General*

Protection of the environment is a major priority for KU and a significant element of its business activities. Extensive federal, state and local environmental laws and regulations are applicable to KU’s air emissions, water discharges and the management of hazardous and solid waste, among other areas; and the costs of compliance or alleged non-compliance cannot be predicted with certainty but could be material. In addition, costs may increase significantly if the requirements or scope of environmental laws or regulations, or similar rules, are expanded or changed from prior versions by the relevant agencies. Costs may take the form of increased capital or operating and maintenance expenses; monetary fines, penalties or forfeitures or other restrictions. Many of these environmental law considerations are also applicable to the operations of key suppliers, or customers, such as coal producers, industrial power users, etc., and may impact the costs of their products or their demand for KU’s services.

##### *Climate Change*

Recent developments continue to indicate an increased possibility of significant climate change or GHG legislation or regulation, at the international, federal, regional and state levels. During December 2009, as part of the United Nation’s Copenhagen Accord, the United States agreed to a non-binding goal to reduce GHG emissions to 17% below 2005 levels by 2020. Additionally, during 2009, the U.S. House of

Representatives passed comprehensive GHG legislation, which included a number of measures to limit GHG emissions and achieve GHG emission reduction targets below 2005 levels of 3% by 2012, 17% by 2020 and 83% by 2050. Similar legislation has been considered in the U.S. Senate, but the prospects for passage remain uncertain. In late 2009, the EPA issued a final endangerment finding relating to mobile sources of GHGs and a GHG reporting requirement beginning in 2010. In 2010, the EPA issued a final rule requiring implementation of best available control technology for GHG emissions from new or modified power plants, effective January 2011. In December 2010, the EPA announced that it intends to propose New Source Performance Standards addressing GHG emissions from new and existing power plants, with a proposed rule expected in July 2011. Finally, a number of U.S. states, although not currently including Kentucky, have adopted GHG-reduction legislation or regulation of various sorts. The developing GHG initiatives include a number of differing structures and formats, including direct limitations on GHG sources, issuance of allowances for GHG emissions, cap-and-trade programs for such allowances, renewable or alternative generation portfolio standards and mechanisms relating to demand reduction, energy efficiency, smart-grid, transmission expansion, carbon-sequestration or other GHG-reducing efforts. While the final terms and impacts of such initiatives cannot be estimated, KU, primarily a coal-fired utility, could be highly affected by such proceedings.

#### *Other Environmental Regulatory Initiatives*

The EPA has proposed or announced that it intends to propose a number of additional environmental regulations that could substantially impact utilities with coal-fired generating assets. These regulatory initiatives include revisions to the ambient air quality standards for SO<sub>2</sub>, NO<sub>2</sub>, ozone and particulate matter 2.5 microns in size or less, rules aimed at mitigating the interstate transport of SO<sub>2</sub> and NO<sub>x</sub>, a program governing emissions of hazardous air pollutants from utility generating units, a program for the management of coal combustion residuals, revised effluent guidelines for utility generating facilities and standards for cooling water intake structures. Such requirements could potentially mandate upgrade of existing emission controls, installation of additional emission controls such as FGDs, SCRs, fabric filter bag houses, activated carbon injection, wet electrostatic precipitators, closure of ash ponds and retrofit of landfills, installation of cooling towers, deployment of new water treatment technologies and retirement of facilities that cannot be retrofitted on a cost effective basis.

The cost to KU and the effect on KU's business of complying with potential GHG restrictions and other environmental regulatory initiatives will depend upon provisions of any final rules and how the rules are implemented by the EPA. Some of the design elements which may have the greatest effect on KU include (a) the required levels and timing of emissions caps, discharge limits or similar standards, (b) the sources covered by such requirements, (c) transition and mitigation provisions, such as phase-in periods, free allowances or price caps, (d) the availability and pricing of relevant mitigation or control technologies, goods or services and (e) economic, market and customer reaction to electricity price and demand changes due to environmental concerns.

Ultimately, environmental matters or potential environmental matters can represent an important element of current or future potential capital requirements, future unit retirement or replacement decisions, supply and demand for electricity, operating and maintenance expenses or compliance risks for the Company. Based on prior regulatory precedent, KU currently anticipates that many of such direct costs may be recoverable through rates or other regulatory mechanisms, particularly with respect to coal-related generation, but the availability, timing or completeness of such rate recovery cannot be assured. Ultimately, climate change and other environmental matters will likely increase the level of

capital expenditures and operating and maintenance costs incurred by the Company during the next several years. With respect to NAAQS, CATR, CAMR replacement and coal combustion byproducts developments, based on a preliminary analysis of proposed regulations, the Company may be required to consider actions such as upgrading existing emissions controls, installing additional emissions controls, upgrading byproducts disposal and storage and possible early replacement of coal-fired units. In order to comply with the coal combustion residual rules and the above referenced air rules, capital expenditures for KU are preliminarily estimated to be in the \$1.5 to \$1.7 billion range over the next ten years, although final costs may substantially vary. This estimate does not include compliance with GHG rules or contemplated water-related environmental changes. See Risk Factors and Note 13, Commitments and Contingencies, for further information.

## Results of Operations

The utility business is affected by seasonal temperatures. As a result, operating revenues (and associated operating expenses) are not generated evenly throughout the year. Revenue and earnings are generally highest during the first and third quarters, and lowest in the second quarter, due to weather.

### Net Income

The following table summarizes the significant components of net income for 2010, 2009 and 2008 and the changes therein:

	Combined	Successor	Predecessor		
	Year Ended December 31, 2010	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31, 2009	2008
Total operating revenues	\$ 1,511	\$ 263	\$ 1,248	\$1,355	\$ 1,405
Total operating expenses	<u>1,161</u>	<u>198</u>	<u>963</u>	<u>1,086</u>	<u>1,145</u>
Operating income	350	65	285	269	260
Equity in earnings of unconsolidated venture	3	-	3	1	30
Interest expense	14	8	6	6	14
Interest expense to affiliated companies	64	2	62	69	58
Other income (expense) – net	<u>(2)</u>	<u>-</u>	<u>(2)</u>	<u>5</u>	<u>8</u>
Income before income taxes	273	55	218	200	226
Income tax expense	<u>98</u>	<u>20</u>	<u>78</u>	<u>67</u>	<u>68</u>
Net income	<u>\$ 175</u>	<u>\$ 35</u>	<u>\$ 140</u>	<u>\$ 133</u>	<u>\$ 158</u>

The change in KU's net income was as follows:

	Increase (Decrease)	
	2010 vs. 2009	2009 vs. 2008
Total operating revenues	\$ 156	\$ (50)
Total operating expenses	75	(59)
Operating income	81	9
Equity in earnings of unconsolidated venture	2	(29)
Interest expense	8	(8)
Interest expense to affiliated companies	(5)	11
Other income (expense) – net	(7)	(3)
Income (loss) before income taxes	73	(26)
Income taxes	31	(1)
Net income	<u>\$ 42</u>	<u>\$ (25)</u>

### Operating Revenues

The \$156 million increase from 2009 to 2010 and \$50 million decrease from 2008 to 2009 in operating revenues were primarily due to:

	Increase (Decrease)	
	2010 vs. 2009	2009 vs. 2008
Retail sales volumes (a)	\$ 73	\$ (43)
Base rate price variance (b)	39	(5)
Demand revenue (c)	16	(1)
Sales to municipal customers (d)	12	(1)
Increased recoverable capital spending billed through the ECR	8	50
Other operating revenue primarily due to late payment charges	6	6
FAC price variance (e)	5	(2)
Merger surcredit termination in February 2009	2	13
Transmission sales	1	-
Increased recoverable program spending billed through the DSM	1	9
Wholesale sales (f)	(7)	(77)
VDT surcredit termination in August 2008	-	1
	<u>\$ 156</u>	<u>\$ (50)</u>

- (a) Retail sales volumes increased during 2010 compared to 2009 as a result of increased consumption primarily due to increased heating degree days during the first and fourth quarters of 2010 and increased cooling degree days during the second and third quarters of 2010. Additionally, improved economic conditions in 2010 and significant storm outages in 2009 contributed to the increased volumes.

The decrease in retail sales volumes during 2009 compared to 2008 was attributable to reduced consumption by retail customers, as a result of milder weather and weakened economic conditions, in addition to significant storm outages during 2009.



- (b) The increase in revenues due to the base rate price variance during 2010 compared to 2009 resulted from higher base rates effective August 1, 2010. See Note 3, Rates and Regulatory Matters, for further discussion of the 2010 Kentucky rate case.

The decrease in revenues due to the base rate price variance during 2009 compared to 2008 resulted from a reduction in base energy rates effective February 6, 2009. See Note 3, Rates and Regulatory Matters, for further discussion of the 2008 Kentucky rate case.

- (c) Demand revenues increased during 2010 compared to 2009 as a result of higher demand rates effective August 1, 2010 and higher customer peak demand. See Note 3, Rates and Regulatory Matters, for further discussion of the 2010 Kentucky rate case.
- (d) The increase in sales to municipal customers during 2010 compared to 2009 was primarily due to increased volumes as a result of increased cooling and heating degree days, improved economic conditions and a decline in storm outages.
- (e) FAC revenues increased during 2010 compared to 2009 as a result of increased recoverable fuel costs billed to customers through the FAC due to higher fuel prices.

The decrease in the FAC revenue during 2009 compared to 2008 resulted from lower fuel costs billed to customers through the FAC (\$2 million) due to a refund of power purchased costs from OMU (\$6 million) partially offset by increased recoverable fuel costs (\$4 million) billed to retail customers through the FAC.

- (f) The decrease in wholesale sales during 2010 compared to 2009 was primarily due to increased consumption by industrial customers, as a result of improved economic conditions, increased consumption by residential customers, as a result of increased cooling and heating degree days and an increase in LG&E's coal-fired generation outages in the first six months of 2010. See Note 15, Related Party Transactions, for further discussion of the mutual agreement for wholesale sales and purchases between KU and LG&E.

The decrease in wholesale sales during 2009 compared to 2008 was primarily due to lower sales volumes to LG&E and third-parties due to lower economic capacity, caused by low spot market pricing and higher scheduled coal-fired generation outages. See Note 15, Related Party Transactions, for further discussion of the mutual agreement for wholesale sales and purchases between KU and LG&E.

## Operating Expenses

Fuel for electric generation comprises a large component of total operating expenses. Increases or decreases in the cost of fuel are reflected in retail rates through the FAC, subject to the approval of the FERC, Kentucky Commission, Virginia Commission and the Tennessee Regulatory Authority. Operating expenses and the changes therein for 2010, 2009 and 2008 follow:

	Combined	Successor	Predecessor		
	Year Ended December 31, 2010	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31, 2009      2008	
Fuel for electric generation	\$ 495	\$ 78	\$ 417	\$ 434	\$ 513
Power purchased	175	28	147	199	221
Other operation and maintenance expenses	346	66	280	320	275
Depreciation and amortization	145	26	119	133	136
	<u>\$ 1,161</u>	<u>\$ 198</u>	<u>\$ 963</u>	<u>\$ 1,086</u>	<u>\$ 1,145</u>

The changes in operating expenses were as follows:

	Increase (Decrease)	
	2010 vs. 2009	2009 vs. 2008
Fuel for electric generation	\$ 61	\$ (79)
Power purchased	(24)	(22)
Other operation and maintenance expenses	26	45
Depreciation and amortization	12	(3)
	<u>\$ 75</u>	<u>\$ (59)</u>

### *Fuel for Electric Generation*

The \$61 million increase from 2009 to 2010 and \$79 million decrease from 2008 to 2009 were primarily due to:

	Increase (Decrease)	
	2010 vs. 2009	2009 vs. 2008
Fuel usage volumes (a)	\$ 77	\$ (97)
Commodity costs for coal	(15)	18
Other	(1)	-
	<u>\$ 61</u>	<u>\$ (79)</u>

- (a) Fuel usage volumes increased in 2010 compared 2009 due to increased native load sales. Fuel usage volumes decreased in 2009 compared to 2008 due to decreased native load and wholesale sales.

### *Power Purchased Expense*

The \$24 million decrease from 2009 to 2010 and \$22 million decrease from 2008 to 2009 were primarily due to:

	Increase (Decrease)	
	2010 vs. 2009	2009 vs. 2008
Power purchased from OMU	\$ (40)	\$ 12
Purchases from LG&E due to volume (a)	(5)	(2)
Demand payments for third party purchases	(2)	1
Prices for purchases used to serve retail customers	7	(14)
Third party purchased volumes for native load (b)	7	(6)
OMU settlement received in 2009	6	(6)
Purchases from LG&E due to prices	3	(7)
	<u>\$ (24)</u>	<u>\$ (22)</u>

- (a) Purchased volumes from LG&E decreased in 2010 compared to 2009 primarily due to increased consumption by residential customers at LG&E as the result of increased cooling and heating degree days, increased coal-fired generation outages in the first six months of 2010 and higher energy usage by industrial customers as a result of improved economic conditions.

Purchased volumes from LG&E decreased in 2009 compared to 2008 due to LG&E's increased scheduled outages at coal-fired generation units during the fourth quarter of 2009. See Note 15, Related Party Transactions, for further discussion of the mutual agreement for wholesale sales and purchases between the Utilities.

- (b) Third party purchase volumes with counterparties other than OMU increased in 2010 compared to 2009 primarily due to the termination of the OMU agreement. Third party purchase volumes with counterparties other than OMU decreased in 2009 compared to 2008 primarily due to availability of power for native load customers from the OMU agreement. See Note 13, Commitments and Contingencies, for further discussion of the OMU settlement.

### *Other Operation and Maintenance Expenses*

The \$26 million increase from 2009 to 2010 was primarily due to \$22 million of increased other operation expenses and \$4 million of increased maintenance expenses. The \$45 million increase from 2008 to 2009 was primarily due to \$30 million of increased other operation expenses and \$15 million of increased maintenance expenses.

Other Operation Expenses:

The \$22 million increase from 2009 to 2010 and \$30 million increase from 2008 to 2009 were primarily due to:

	Increase (Decrease)	
	2010 vs. 2009	2009 vs. 2008
Administrative and general expense (a)	\$ 9	\$ 3
Transmission expense (b)	5	-
Bad debt expense (c)	4	(1)
Steam expense (d)	4	7
Generation expense	2	(2)
DSM program spending	-	9
Legal expenses (e)	-	(6)
Other power supply	(1)	-
Pension expense (f)	(2)	20
Other	1	-
	<u>\$ 22</u>	<u>\$ 30</u>

- (a) Administrative and general expense increased in 2010 compared 2009 primarily due to higher labor expense and insurance expense, partially offset by lower IT expense related to the implementation of the Customer Care Solution system in 2009. Administrative and general expense increased in 2009 compared to 2008 primarily due to increased consulting fees for software training and increased labor and benefit costs.
- (b) Transmission expense increased in 2010 compared to 2009 primarily due to a settlement agreement with a third party and the establishment of a regulatory asset approved by the Kentucky Commission for the EKPC settlement in 2009, net of twelve months of amortization expense recorded in 2010.
- (c) Bad debt expense increased in 2010 compared to 2009 due to higher billed revenues, higher late payment charges and a higher net charge-off percentage.
- (d) Steam expense increased in 2010 compared to 2009 primarily due to increased generation in 2010. Steam expense increased in 2009 compared to 2008 primarily due to the utilization of SCRs year-round.
- (e) Legal expenses decreased in 2009 compared to 2008 primarily due to OMU expenses in 2008. See Note 13, Commitments and Contingencies, for further information regarding the OMU settlement.
- (f) Pension expense decreased in 2010 compared to 2009 primarily due to favorable asset performance in 2009 and increased in 2009 compared to 2008 primarily due to unfavorable asset performance in 2008.

#### Other Maintenance Expenses:

The \$4 million increase from 2009 to 2010 and \$15 million increase from 2008 to 2009 were primarily due to:

	Increase (Decrease)	
	2010 vs. 2009	2009 vs. 2008
Generation expense (a)	\$ 3	\$ -
Steam expense (b)	2	7
Administrative and general expense	2	1
Transmission expense	-	2
Distribution expense (c)	(3)	5
	<u>\$ 4</u>	<u>\$ 15</u>

- (a) Generation expense increased in 2010 compared to 2009 primarily due to the overhaul of Paddy's Run Unit 13.
- (b) Steam expense increased in 2009 compared to 2008 due to increased scope of work for scheduled outages.
- (c) Distribution expense decreased in 2010 compared to 2009 primarily due to higher storm cost in 2009, partially offset by higher tree trimming expense in 2010. Distribution expense increased in 2009 compared to 2008 primarily due to increased repairs, higher tree trimming expense and higher storm related expense.

#### Equity in Earnings of Unconsolidated Venture

The \$2 million increase in equity in earnings of unconsolidated venture, from 2009 to 2010, was primarily due to higher earnings from EEI resulting from increased market prices for electric energy and the \$29 million decrease from 2008 to 2009 was primarily due to lower earnings resulting from decreased market prices for electric energy.

#### Interest Expense

The \$3 million increase from 2009 to 2010 and \$3 million increase from 2008 to 2009 were primarily due to:

	Increase (Decrease)	
	2010 vs. 2009	2009 vs. 2008
Bond interest expense (a)	\$ 8	\$ (8)
Interest expense to affiliated companies (b)	(5)	11
	<u>\$ 3</u>	<u>\$ 3</u>

- (a) Bond interest expense increased in 2010 compared to 2009 due to the issuance of first mortgage bonds in November 2010. Bond interest expense decreased in 2009 compared to 2008 due to lower interest rates on pollution control bonds. See Note 11, Long-Term Debt, for further information.
- (b) Interest expense to affiliated companies decreased in 2010 compared to 2009 primarily due to notes payable to Fidelia being paid in full in November 2010, as a result of the PPL acquisition. Interest expense to affiliated companies increased in 2009 compared to 2008 primarily due to the

issuance of additional debt (\$13 million), which was partially offset by lower interest rates on intercompany short-term borrowings.

### Other Income (Expense) – Net

The \$7 million decrease in other income (expense) – net from 2009 to 2010 and the \$3 million decrease in other income (expense) – net from 2008 to 2009 were primarily due to the discontinuance of the allowance for funds used during construction on ECR projects as a result of the FERC rate case.

### Income Tax Expense

See Note 10, Income Taxes, for a reconciliation of differences between the U.S. federal income tax expense at statutory rates and KU's income tax expense.

### 2011 Outlook

KU projects higher earnings in 2011 compared with 2010 as a net result of higher retail revenues and lower financing costs due to the issuance of first mortgage bonds in late 2010, partially offset by higher operation and maintenance expenses and depreciation. Retail revenues are expected to increase as a result of the 2010 Kentucky rate case and recoveries associated with its environmental investments. Operation and maintenance expenses and depreciation are expected to increase due to placing TC2 in service in January 2011. See Risk Factors for a discussion of the risk factors that may impact the 2011 outlook.

## **Financial Condition**

### Liquidity and Capital Resources

KU expects to continue to have adequate liquidity available through operating cash flows, cash and cash equivalents and its credit facilities. KU currently has no plans to access debt capital markets in 2011.

KU's cash flows from operations and access to cost-effective bank and capital markets are subject to risks and uncertainties including, but not limited to, the following:

- changes in market prices for electricity;
- potential ineffectiveness of the trading, marketing and risk management policy and programs used to mitigate KU's risk exposure to adverse electricity and fuel prices and interest rates;
- operational and credit risks associated with selling and marketing products in the wholesale power markets;
- unusual or extreme weather that may damage KU's transmission and distribution facilities or affect energy sales to customers;
- unavailability of generating units (due to unscheduled or longer than anticipated generation outages, weather and natural disasters) and the resulting loss of revenues and additional costs of replacement electricity;
- ability to recover and timeliness and adequacy of recovery of costs;
- costs of compliance with existing and new environmental laws;

- any adverse outcome of legal proceedings and investigations with respect to KU's current and past business activities;
- deterioration in the financial markets that could make obtaining new sources of bank and capital markets funding more difficult and more costly; and
- a downgrade in KU's credit ratings that could adversely affect its ability to access capital and increase the cost of credit facilities and any new debt.

See the Risk Factors section for further discussion of risks and uncertainties affecting KU's cash flows.

At December 31, KU had the following:

	Successor	Predecessor
	2010	2009
Cash and cash equivalents	\$ <u>3</u>	\$ <u>2</u>
Current portion of long-term debt (a)	\$ -	\$ 228
Current portion of long-term debt to affiliated company (b)	-	33
Notes payable to affiliated companies (c)	<u>10</u>	<u>45</u>
	<u>\$ 10</u>	<u>\$ 306</u>

- (a) 2009 amount represents Carroll County 2002 Series A and B, 2004 Series A, 2006 Series B and 2008 Series A; Muhlenberg County 2002 Series A; and Mercer County 2000 Series A and 2002 Series A pollution control bonds subject to tender for purchase at the option of the holder and to mandatory tender for purchase upon the occurrence of certain events. The Successor has classified these bonds as long-term because the Company has the intent and ability to utilize its \$400 million credit facility which matures in December 2014, to fund any mandatory purchases. The Predecessor classified these bonds as the current portion of long-term debt due to the tender for purchase provisions. The Predecessor presentation and the Successor presentation are both appropriate under GAAP. See Note 1, Summary of Significant Accounting Policies, and Note 11, Long-Term Debt, for further information.
- (b) 2009 amount represents debt owed to an E.ON affiliate, which was repaid in November 2010. See Note 11, Long-Term Debt, for further information.
- (c) Amounts represent borrowings under KU's intercompany money pool agreement wherein LKE and/or LG&E make funds available to KU at market-based rates of up to \$400 million. See Note 12, Notes Payable and Other Short-Term Obligations, for further information.

A condensed table of cash flows for the following periods in 2010, 2009 and 2008 is presented below. The Predecessor period, January 1, 2010 through October 31, 2010, and the Successor period, November 1, 2010 through December 31, 2010, were aggregated without further adjustment for purposes of comparison with the same periods in 2009 and 2008.

	Combined	Successor	Predecessor		
	Year Ended December 31, 2010	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31, 2009	2008
Net cash provided by (used in) operating activities	\$ 372	\$ 28	\$ 344	\$ 253	\$ 292
Net cash provided by (used in) investing activities	(427)	(87)	(340)	(507)	(695)
Net cash provided by (used in) financing activities	<u>56</u>	<u>58</u>	<u>(2)</u>	<u>254</u>	<u>405</u>
Change in cash and cash equivalents	<u>\$ 1</u>	<u>\$ (1)</u>	<u>\$ 2</u>	<u>\$ -</u>	<u>\$ 2</u>

#### *Operating Activities*

Net cash provided by operating activities increased by 47%, or \$119 million, in 2010 compared with 2009, primarily as a result of increased earnings, increased collections from the ECR mechanism and lower storm expenses. These increases in cash flow were partially offset by higher interest payments due to an accelerated settlement with the previous owner and higher 2010 income tax payments due to higher taxable income and investment tax credit benefits received in 2009.

Net cash provided by operating activities decreased by 13%, or \$39 million, in 2009 compared with 2008, primarily as a result of higher storm expenses, decreased earnings and unfavorable changes in working capital. These decreases in cash flow were partially offset by lower income tax payments due to lower taxable income and investment tax credit benefits received.

KU expects to achieve relatively stable cash flows from operations during the next three years although future cash flows may be significantly impacted by changes in economic conditions or new environmental and tax regulations.

#### *Investing Activities*

The primary use of cash in investing activities is capital expenditures. See "Forecasted Uses of Cash" for detail regarding projected capital expenditures for the years 2011 through 2013.

Net cash used in investing activities decreased by 16%, or \$80 million, in 2010 compared with 2009, primarily as a result of a decrease of \$89 million in capital expenditures, partially offset by a decrease of \$9 million from restricted cash collections.



Net cash used in investing activities decreased by 27%, or \$188 million, in 2009 compared with 2008, primarily as a result of a decrease of \$180 million in capital expenditures and a increase of \$8 million from restricted cash collections.

#### *Financing Activities*

Net cash provided by financing activities was \$56 million in 2010 compared with \$254 million in 2009. In spite of significant new debt issuances associated with the repayments to E.ON affiliates in connection with PPL's acquisition of the Company, cash provided by financing was less in 2010 due to lower increases in debt in 2010 and the payment of dividends in 2010; whereas, KU received equity contributions in 2009.

Net cash provided by financing activities was \$254 million in 2009 compared with \$405 million in 2008. The lower level of cash provided by financing in 2009 was the result of lower debt issuance to affiliated companies and lower levels of equity contributions received.

In the two months of 2010 following the acquisition, cash provided by financing activities of the Successor primarily consisted of the issuance of first mortgage bonds totaling \$1,489 million after discounts and the issuance of intercompany notes totaling \$1,331 million to a PPL subsidiary to repay debt due to an E.ON affiliate upon the closing of the sale. These amounts were offset by the repayment of \$1,331 million to an E.ON affiliate upon the closing of the sale, the repayment of \$1,331 million to a PPL affiliate upon the issuance of the first mortgage bonds, the repayment of \$83 million of short-term borrowings due to an affiliated company and the payment of \$17 million of debt issuance costs.

In 2010, cash used in financing activities by the Predecessor primarily consisted of the payment of \$50 million of dividends to LKE mostly offset by increases in short-term borrowings due to an affiliated company totaling \$48 million.

In 2009, cash provided by financing activities primarily consisted of the issuance of \$150 million of intercompany notes to an E.ON affiliate, the receipt of capital contributions from LKE totaling \$75 million and a \$29 million increase in short-term borrowings due to an affiliated company.

In 2008, cash provided by financing activities primarily consisted of the issuance of \$250 million of intercompany notes to an E.ON affiliate, the receipt of capital contributions from LKE totaling \$145 million and a \$7 million reduction in short-term borrowings due to an affiliated company. In addition, KU reacquired pollution control bonds totaling \$80 million, reissued \$63 million of that \$80 million and issued \$77 million of new pollution control bonds. Of the \$77 million, \$60 million was used to retire prior pollution control bonds, including the remaining \$17 million which had been reacquired by the Company. This resulted in a cash receipt of \$17 million to KU.

KU's debt financing activity in 2010 was:

	<u>Issuances (a)</u>	<u>Retirements</u>
Short-term borrowings from affiliated company – net change	\$ -	\$ (35)
Other borrowings from affiliated company	1,331	(1,331)
Borrowings from an E.ON affiliate	-	(1,331)
Issuance of bonds	1,489	-
Net change in debt financing	<u>\$ 2,820</u>	<u>\$ (2,697)</u>

(a) Issuances are net of pricing discounts, where applicable.

See Note 11, Long-Term Debt, for further information.

#### Working Capital Deficiency

As of December 31, 2009, KU had a working capital deficiency of \$203 million, primarily due to the current portion of long-term debt to affiliated company totaling \$33 million and \$228 million of tax-exempt bonds which allow the investors to put the bonds back to the Company causing them to be classified as "Current portion of long-term debt." As of December 31, 2010, the Company no longer had a working capital deficiency because the current portion of long-term debt to affiliated company was paid off in conjunction with the PPL acquisition, and the \$228 million of tax-exempt bonds were no longer classified as "Other current liabilities" by the Successor because the Company has the intent and ability to utilize its \$400 million credit facility which expires in December 2014 to fund any mandatory purchases. See Note 11, Long-Term Debt, for further information.

#### Auction Rate Securities

Auctions for auction rate securities issued by KU continued to fail throughout 2010. See Note 11, Long-Term Debt, for further discussion.

#### Forecasted Sources of Cash

KU expects to continue to have adequate sources of cash available in the near term, including access to external financing, financing from affiliates and/or infusions of capital from LKE. Regulatory approvals are required for KU to incur additional debt. The FERC and the Virginia Commission authorize the issuance of short-term debt while the Kentucky Commission, Virginia Commission and the Tennessee Regulatory Authority authorize the issuance of long-term debt. In November 2009, KU received a two-year authorization from the FERC to borrow up to \$400 million in short-term funds. KU also has authorization from the Virginia Commission that expires at the end of 2011, allowing short-term borrowing of up to \$400 million. Short-term funds are made available via the Company's participation in an intercompany money pool agreement wherein LKE and/or LG&E make funds available to KU at market-based rates (based on highly rated commercial paper issues) up to \$400 million or via the \$400 million Revolving Credit Agreement discussed below. KU currently believes this authorization and these facilities, together with the Company's credit facilities discussed below, provide the necessary flexibility to address any liquidity needs.

#### *Credit Facilities*

On November 1, 2010, KU entered into a \$400 million unsecured Revolving Credit Agreement with a group of banks. Under this new credit facility, which expires on December 31, 2014, KU has the ability to make cash borrowings and to request the lenders to issue letters of credit. Borrowings will generally bear interest at LIBOR-based rates plus a spread, depending upon KU's senior unsecured long-term debt rating. The new credit facility contains financial covenants requiring KU's debt to total capitalization to not exceed 70% and other customary covenants. As of December 31, 2010, KU's debt to total capitalization was 41% as calculated pursuant to the credit agreement. Under certain conditions, KU may request that the facility's capacity be increased by up to \$100 million. This new credit facility

replaced an existing bilateral line of credit totaling \$35 million that was terminated November 1, 2010. As of December 31, 2010, there was no outstanding balance under the new credit facility, but there were \$198 million of letters of credit outstanding to support outstanding bonds totaling \$195 million. KU will utilize unused credit facility and money pool balances to fund working capital needs as they arise. See Note 12, Notes Payable and Other Short-Term Obligations, for further information regarding the Company's credit facilities.

*Contributions from LKE*

LKE may make capital contributions to KU, which can be used for general business purposes.

*Long-Term Debt*

KU currently does not plan to issue any new long-term debt in 2011.

Forecasted Uses of Cash

In addition to expenditures required for normal operating activities, such as fuel for electric generation, power purchased, payroll and taxes; KU currently expects to incur future cash outflows for capital expenditures, various contractual obligations and the payment of dividends.

*Capital Requirements*

KU's construction program is designed to ensure that there will be adequate capacity and reliability to meet the electric needs of its service area and to comply with environmental regulations. These needs are continually being reassessed and appropriate revisions are made, when necessary, in construction schedules. KU plans to fund capital expenditures through operating cash flows, the credit facility and, if needed, the issuance of long-term debt. KU expects its capital expenditures for the three year period ending December 31, 2013, to total approximately \$1,406 million, consisting primarily of the following:

Construction of coal combustion residual storage structures	\$ 346
Construction of environmental controls and capacity replacement	302
Construction of distribution and metering assets	260
Construction of generation assets	206
Construction of transmission assets	129
Recoverable environmental assets	99
Information technology projects	39
Other projects	25
	<u>\$ 1,406</u>

The Company's capital program will focus primarily on compliance with existing or anticipated EPA environmental regulations, aging infrastructure and the need for increased storage capacity for coal combustion by-product materials over the next several years. This program may also be affected in varying degrees by factors such as electric energy demand load growth, changes in construction expenditure levels, rate actions by regulatory agencies, new legislation, changes in commodity prices and labor rates and other regulatory requirements. In particular, climate change initiatives, whether via legislative, regulatory or market channels, could restrict or disadvantage power generation from higher-

carbon sources. Therefore, KU has included estimates regarding significant additional capital expenditures related to pending environmental regulations and legislation. These estimates are subject to final regulations and least cost analysis based on engineering studies. To the extent financial markets see climate change as a potential risk, KU may face reduced access to or increased costs in capital markets. Capital expenditures for KU associated with such actions are preliminarily estimated to be in the \$1.5 to \$1.7 billion range over the next ten years, although final costs may substantially vary.

See the Contractual Obligations table below and Note 13, Commitments and Contingencies, for further information concerning commitments.

### *Contractual Obligations*

The following is provided to summarize contractual cash obligations for periods after December 31, 2010. KU anticipates cash from operations and external financing will be sufficient to fund future obligations. See the Statements of Capitalization.

	Payments Due by Period						Total
	2011	2012	2013	2014	2015	Thereafter	
Short-term debt (a)	\$ 10	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 10
Long-term debt (b)	-	-	-	-	250	1,601	1,851
Interest on long-term debt (c)	67	69	72	75	78	1,414	1,775
Operating leases (d)	8	7	5	5	3	1	29
Unconditional power purchase obligations (e)	9	10	10	10	10	114	163
Coal and natural gas purchase obligations (f)	439	200	144	93	91	14	981
Pension benefit plan obligations (g)	18	24	28	10	7	60	147
Postretirement benefit plan obligations (h)	5	6	6	6	6	33	62
Construction obligations (i)	113	3	-	-	-	-	116
Other obligations (j)	3	3	-	-	-	-	6
	<u>\$ 672</u>	<u>\$ 322</u>	<u>\$ 265</u>	<u>\$ 199</u>	<u>\$ 445</u>	<u>\$ 3,237</u>	<u>\$ 5,140</u>

This table does not reflect contingent obligations. See Note 13, Commitments and Contingencies, for further information on contingent obligations.

- (a) Represents borrowings due to affiliates within one year.
- (b) Reflects principal maturities only based on legal maturity dates and includes the current portion of long-term debt.
- (c) Assumes interest payments through maturity. The payments herein are subject to change as payments for debt that is or becomes variable-rate debt have been estimated.
- (d) Represents future operating lease payments.
- (e) Represents future minimum payments under OVEC power purchase agreements through March 13, 2026.
- (f) Represents contracts to purchase coal, natural gas and natural gas transportation.

- (g) Represents projected cash flows for funding the pension benefit plans as calculated by the actuary. For pension funding information see Note 9, Pension and Other Postretirement Benefit Plans.
- (h) Represents projected cash flows for the postretirement benefit plan as calculated by the actuary. For postretirement funding information, see Note 9, Pension and Other Postretirement Benefit Plans.
- (i) Represents construction commitments, including commitments for the Brown SCR and the Brown and Ghent landfill construction including associated material transport systems for coal combustion residual.
- (j) Represents other contractual obligations including the SPP and TVA coordination agreements.

#### *Pension and Postretirement Benefit Plans*

See Application of Critical Accounting Policies and Estimates for discussion regarding discretionary contributions to the pension and postretirement benefit plans in 2011.

#### *Dividends*

Future dividends may be declared at the discretion of KU's Board of Directors, payable to its sole shareholder, LKE. As discussed in Note 12, Notes Payable and Other Short-Term Obligations, KU's dividend payments are limited under a covenant in its \$400 million revolving line of credit facility. This covenant restricts the debt to total capital ratio to not more than 70%. KU is subject to Section 305(a) of the Federal Power Act, which makes it unlawful for a public utility to make or pay a dividend from any funds "properly included in capital account." The meaning of this limitation has never been clarified under the Federal Power Act. KU believes, however, that this statutory restriction, as applied to its circumstances, would not be construed or applied by the FERC to prohibit the payment from retained earnings of dividends that are not excessive and are for lawful and legitimate business purposes.

#### *Purchase, Redemption or Remarketing of Debt Securities*

KU will continue to evaluate purchasing, redeeming or remarketing outstanding debt securities and may decide to take action depending upon prevailing market conditions and available cash.

#### Credit Ratings

KU's credit ratings reflect the views of three national rating agencies. A security rating is not a recommendation to buy, sell or hold securities and is subject to revision or withdrawal at any time by the rating agency. In October 2010, one national rating agency revised downward the short-term credit rating of the pollution control bonds and the issuer rating of the Company as a result of the then pending acquisition by PPL. Another raised the long-term rating of the pollution control bonds as a result of the addition of the first mortgage bonds as collateral. In October 2010, a third national rating agency provided an initial rating of the Company's pollution control bonds and first mortgage bonds. See Note 11, Long-Term Debt, for a discussion of downgrade actions in 2009 and 2008 related to the pollution control bonds caused by a change in the rating of the entity insuring those bonds.

### Ratings Triggers

KU has various derivative and non-derivative contracts, including contracts for the sale and purchase of electricity and fuel and commodity transportation, which contain provisions requiring KU to post additional collateral, or permit the counterparty to terminate the contract if KU's credit rating were to fall below investment grade. See Note 5, Derivative Financial Instruments, for a discussion of Credit Risk Related Contingent Features, including a discussion of the potential additional collateral that would have been required for derivative contracts in a net liability position at December 31, 2010. At December 31, 2010, if KU's credit ratings had been below investment grade, KU would have been required to prepay or post an additional \$16 million of collateral to counterparties for both derivative and non-derivative commodity and commodity-related contracts used in its generation, marketing and trading operations.

### Off-Balance Sheet Arrangements

KU has very limited off-balance sheet activity. See Note 13, Commitments and Contingencies, for further discussion.

### Risk Management

#### *Credit Risk*

KU is exposed to potential losses as a result of nonperformance by counterparties of their contractual obligations. KU maintains credit policies and procedures to limit counterparty credit risk including evaluating credit ratings and financial information along with having certain counterparties post margin if the credit exposure exceeds certain thresholds. See Note 5, Derivative Financial Instruments, for information regarding risk management activities.

KU is exposed to potential losses as a result of nonpayment by customers. The Company maintains an allowance for doubtful accounts composed of accounts aged more than four months. Accounts are written off as management determines them uncollectible. See Application of Critical Accounting Policies and Estimates and Note 1, Summary of Significant Accounting Policies, for further discussion.

Certain of the Company's derivative instruments contain provisions that require it to provide immediate and on-going collateralization on derivative instruments in net liability positions based upon the Company's credit ratings from each of the major credit rating agencies. See Note 5, Derivative Financial Instruments, for information regarding exposure and the risk management activities.

#### *Liquidity Risk*

KU expects to continue to have access to adequate sources of liquidity through operating cash flows, cash and cash equivalents, credit facilities and/or infusion of capital from its parent. See Financial Condition - Liquidity and Capital Resources for an expanded discussion of KU's liquidity position and a discussion of its forecasted sources of cash.

### *Securities Price Risk*

KU has securities price risk through its participation in defined benefit pension and postretirement benefit plans. Declines in the market price of debt and equity securities could impact contribution requirements. See Application of Critical Accounting Policies and Estimates - Defined Benefits for a discussion of the assumptions and sensitivities regarding the defined benefit pension and postretirement benefit plans assumptions.

### *Interest Rate and Commodity Price Risk*

KU is subject to interest rate and commodity price risk related to on-going business operations. It currently manages commodity risks using derivative instruments, including swaps and forward contracts. The Company's policies allow for the interest rate risk to be managed through the use of fixed rate debt, floating rate debt and interest rate swaps. At December 31, 2010, no interest rate swaps were in effect for KU. At December 31, 2010, the Company's annual exposure to increased interest expense, based on a 10% increase in interest rates, was less than \$1 million.

KU manages price risk by conducting energy trading activities through forward financial transactions. The following chart sets forth the net fair value of KU's commodity derivative contracts. See Note 5 Derivative Financial Instruments, for further information.

	Successor	Predecessor	
	December 31, 2010 (a)	October 31, 2010 (a)	December 31, 2009
Fair value of contracts outstanding at the beginning of the period	\$ -	\$ -	\$ 1
Contracts realized or otherwise settled during the period	-	-	
Fair value of new contracts entered into during the period	-	-	-
Changes in fair value attributable to changes in valuation techniques	-	-	-
Other changes in fair value	-	-	(1)
Fair value of contracts outstanding at the end of the period	\$ -	\$ -	\$ -

(a) 2010 activity is less than \$1 million.

### Related Party Transactions

KU and its Parent, LKE and subsidiaries of LKE engage in related party transactions. See Note 15, Related Party Transactions, for further information.

KU is not aware of any material ownership interest or operating responsibility by the executive officers of KU in outside partnerships, including leasing transactions with variable interest entities, or entities doing business with KU.

### Acquisitions, Development and Divestitures

KU and LG&E have been constructing a new 760-Mw capacity base-load, coal-fired unit, TC2, which is jointly owned by KU (60.75%) and LG&E (14.25%), together with IMEA and IMPA (combined 25%). With limited exceptions the Company took care, custody and control of TC2 on January 22, 2011, and has dispatched the unit to meet customer demand since that date. KU and the contractor agreed to a further amendment of the construction agreement whereby the contractor will complete certain actions relating to identifying and completing any necessary modifications to allow operation of TC2 on all fuels in accordance with initial specifications prior to certain dates, and amending the provisions relating to liquidated damages. See Note 13, Commitments and Contingencies, for further information.

KU continuously re-examines development projects based on market conditions and other factors to determine whether to proceed, to cancel or to expand the projects.

### **Application of Critical Accounting Policies and Estimates**

The financial statements of KU are prepared in compliance with GAAP. The application of these principles necessarily involves judgments regarding future events, including legal and regulatory challenges and anticipated recovery of costs. These judgments could materially impact the financial statements and disclosures based on varying assumptions, which may be appropriate to use. In addition, the financial and operating environment also may have a significant effect, not only on the operation of the business, but also on the results reported through the application of accounting measures used in preparing the financial statements and related disclosures, even if the nature of the accounting policies applied has not changed. KU's senior management has reviewed the significant and critical accounting policies with the relevant governing bodies of the Company and its parent, as applicable.

An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, if different estimates reasonably could have been used or if changes in the estimate that are reasonably possible could materially impact the financial statements. Management believes the following critical accounting policies reflect the significant estimates and assumptions used in the preparation of the Financial Statements.

### Price Risk Management

See Financial Condition - Risk Management.

### Regulatory Mechanisms

KU is a cost-based rate-regulated utility. As a result, the financial statements reflect the effects of regulatory actions. Regulatory assets are recognized for the effect of transactions or events where future recovery is probable in regulated customer rates. The effect of such accounting is to defer certain or qualifying costs that would otherwise be charged to expense. Likewise, regulatory liabilities are recognized for obligations expected to be returned through future regulated customer rates. The effect of such transactions or events would otherwise be reflected as income. In certain cases, regulatory liabilities are recorded based on the understanding with the regulator that current rates are being set to recover costs that are expected to be incurred in the future. The regulated entity is accountable for any amounts charged pursuant to such rates and not yet expended for the intended purpose. The accounting



for regulatory assets and liabilities is based on specific ratemaking decisions or precedent for each transaction or event as prescribed by the FERC, the Kentucky Commission, the Virginia Commission or the Tennessee Regulatory Authority. See Note 3, Rates and Regulatory Matters, for additional detail regarding regulatory assets and liabilities.

### Defined Benefits

KU employees benefit from both funded and unfunded retirement benefit plans. See Note 1, Summary of Significant Accounting Policies, for information about policy changes between the Predecessor and Successor and the accounting for defined benefits including KU's method of amortizing gains and losses. KU makes various assumptions in arriving at pension and other postretirement benefit costs and obligations. The major assumptions include:

- KU's selection of discount rates is based on the Mercer Pension Discount Yield Curve (Predecessor) and the Towers Watson Yield Curve (Successor).
- KU's selection of rate of salary growth is based on historical data that includes employees' periodic pay increases and promotions, which are used to project employees' pension benefits at retirement.
- KU determines the expected long-term return on plan assets based on the current level of expected return on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class is then weighted based on the current asset allocation.
- KU's management projects health care cost trends based on past health care costs, the near-term outlook and an assessment of likely long-term trends.

The performance of the capital markets affects the values of the assets that are held in trust to satisfy future obligations under the defined benefit pension plans. The return on investments within the plans was approximately 12% for the year ended December 31, 2010. The benefit plan assets and obligations are re-measured annually using a December 31 measurement date. Due to the PPL acquisition, the benefit plan assets and obligations were also re-measured at October 31, 2010. The Company's 2010 pension cost was approximately \$3 million less than 2009. The Company anticipates its 2011 pension cost will be approximately \$3 million less than the 2010 expense. The amount of future funding will depend upon the actual return on plan assets, the discount rate and other factors, but the Company funds its pension obligations in a manner consistent with the Pension Protection Act of 2006. The Company made discretionary contributions to its pension plan of \$13 million in 2010 and 2009, respectively. In January 2011, KU contributed \$43 million to its pension plan. See Note 18, Subsequent Events, for further information.

See Note 9, Pension and Other Postretirement Benefit Plans, for further information on defined benefits including sensitivity analysis expressing potential changes in expected returns that would result from hypothetical changes to assumptions and estimates, expected rate of return assumptions and health care trends.

## Asset Impairment

KU performs a quarterly review to determine if an impairment analysis is required for long-lived assets that are subject to depreciation or amortization. This review identifies changes in circumstances indicating that a long-lived asset's carrying value may not be recoverable. An impairment analysis will be performed if warranted based on the review. For these long-lived assets, such events or changes in circumstances which may indicate an impairment analysis is required include:

- a significant decrease in the market price of an asset;
- a significant adverse change in the manner in which an asset is being used or in its physical condition;
- a significant adverse change in legal factors or in the business climate;
- an accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of an asset;
- a current-period operating or cash flow loss combined with a history of losses or a forecast that demonstrates continuing losses;
- a current expectation that, more likely than not, an asset will be sold or otherwise disposed of before the end of its previously estimated useful life; and
- a significant change in the physical condition of an asset.

For a long-lived asset, impairment is recognized when the carrying amount of the asset is not recoverable and exceeds its fair value. The carrying amount is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. If the asset is impaired, an impairment loss is recorded to adjust the asset's carrying value to its estimated fair value. Management must make significant judgments to estimate future cash flows including the useful lives of long-lived assets, the fair value of the assets and management's intent to use the assets. KU did not recognize an impairment of any long-lived asset in 2010.

Effective with PPL's acquisition of LKE on November 1, 2010, KU recorded \$607 million of goodwill. At December 31, 2010, KU's goodwill remained unchanged. GAAP requires goodwill to be tested for impairment on an annual basis or more frequently if events or circumstances indicate that assets may be impaired. KU performs its annual goodwill impairment test in the fourth quarter. See Note 7, Goodwill and Intangible Assets, for further discussion.

Goodwill is tested for impairment using a two-step approach. In step 1, the Company identifies a potential impairment by comparing the estimated fair value of the Company (the goodwill reporting unit) to its carrying value, including goodwill, on the measurement date. If the estimated fair value exceeds its carrying amount, goodwill is not considered impaired. If the carrying amount exceeds the estimated fair value, the second step is performed to measure the amount of impairment loss, if any.

The second step requires a calculation of the implied fair value of goodwill. The implied fair value of goodwill is determined in the same manner as the amount of goodwill in a business combination. That is, the estimated fair value is allocated to all of KU's assets and liabilities as if KU had been acquired in a business combination and the estimated fair value of KU was the price paid. The excess of the estimated fair value of KU over the amounts assigned to its assets and liabilities is the implied fair value of goodwill. The implied fair value of goodwill is then compared with the carrying amount of that goodwill. If the

carrying amount exceeds the implied fair value, an impairment loss is recognized in an amount equal to that excess. The loss recognized cannot exceed the carrying amount of the reporting unit's goodwill.

Determining the fair value of KU is judgmental in nature and involves the use of significant estimates and assumptions. These estimates and assumptions can include revenue growth rates and operating margins used to calculate projected future cash flows, risk adjusted discount rates and future economic and market conditions.

KU tested goodwill for impairment in the fourth quarter of 2010 and no impairment was recognized. See Note 7, Goodwill and Intangible Assets, for further discussion.

### Loss Accruals

KU accrues losses for the estimated impacts of various conditions, situations or circumstances involving uncertain or contingent future outcomes. For loss contingencies, the loss must be accrued if (1) information is available that indicates it is probable that a loss has been incurred, given the likelihood of the uncertain future events and (2) the amount of the loss can be reasonably estimated. Accounting guidance defines "probable" as cases in which "the future event or events are likely to occur." KU does not record the accrual of contingencies that might result in gains, unless recovery is assured. KU continuously assesses potential loss contingencies for environmental remediation, litigation claims, regulatory penalties and other events.

The accounting aspects of estimated loss accruals include (1) the initial identification and recording of the loss, (2) the determination of triggering events for reducing a recorded loss accrual and (3) the ongoing assessment as to whether a recorded loss accrual is sufficient. All three of these aspects require significant judgment by KU's management. KU uses its internal expertise and outside experts (such as lawyers and engineers), as necessary, to help estimate the probability that a loss has been incurred and the amount or range of the loss.

KU has identified certain other events that could give rise to a loss, but that do not meet the conditions for accrual. Such events are disclosed, but not recorded, when it is reasonably possible that a loss has been incurred. Accounting guidance defines "reasonably possible" as cases in which "the future event or events occurring is more than remote, but less than likely to occur." See Note 13, Commitments and Contingencies, for disclosure of other potential loss contingencies that have not met the criteria for accrual.

When an estimated loss is accrued, KU identifies, where applicable, the triggering events for subsequently adjusting the loss accrual. The triggering events generally occur when the contingency has been resolved and the actual loss is incurred, or when the risk of loss has diminished or been eliminated. The following are some of the triggering events that provide for the adjustment of certain recorded loss accruals:

- Allowances for uncollectible accounts are reduced when accounts are written off after prescribed collection procedures have been exhausted, a better estimate of the allowance is determined or underlying amounts are ultimately collected.
- Environmental and other litigation contingencies are reduced when the contingency is resolved, KU makes actual payments, a better estimate of the loss is determined or the loss is no longer considered probable.

KU reviews its loss accruals on a regular basis to assure that the recorded potential loss exposures are appropriate. This involves ongoing communication and analyses with internal and external legal counsel, engineers, operation management and other parties. This review may result in the increase or decrease of the loss accrual.

### Asset Retirement Obligations

KU is required to recognize a liability for legal obligations associated with the retirement of long-lived assets. The initial obligation is measured at its estimated fair value. An equivalent amount is recorded as an increase in the value of the capitalized asset and allocated to expense over the useful life of the asset. Until the obligation is settled, the liability is increased, through the recognition of accretion expense in the Statements of Income, for changes in the obligation due to the passage of time. An offsetting regulatory asset is recognized to reverse the depreciation and accretion expense related to the ARO such that there is no income statement impact. The regulatory asset is relieved when the ARO has been settled. An ARO must be recognized when incurred if the fair value of the ARO can be reasonably estimated.

In determining AROs, management must make significant judgments and estimates to calculate fair value. Fair value is developed using an expected present value technique based on assumptions of market participants that considers estimated retirement costs in current period dollars that are inflated to the anticipated retirement date and then discounted back to the date the ARO was incurred. Changes in assumptions and estimates included within the calculations of the fair value of AROs could result in significantly different results than those identified and recorded in the financial statements. Estimated ARO costs and settlement dates, which affect the carrying value of various AROs and the related assets, are reviewed periodically to ensure that any material changes are incorporated into the estimate of the obligations. Any change to the capitalized asset is amortized over the remaining life of the associated long-lived asset. See Note 4, Asset Retirement Obligations, for further information on AROs.

At December 31, 2010, KU had AROs totaling \$54 million recorded on the Balance Sheets. Of the total amount, \$35 million, or 65%, relates to KU's ash ponds and landfills. The most significant assumptions surrounding AROs are the forecasted retirement costs, the discount rates and the inflation rates. A variance in the forecasted retirement costs, the discount rates or the inflation rates could have a significant impact on the ARO liabilities.

The following chart reflects the sensitivities related to KU's ARO liabilities for ash ponds and landfills as of December 31, 2010:

	<u>Change in Assumption</u>	<u>Impact on ARO Liability</u>
Retirement cost	10%/(10)%	\$4/\$ (4)
Discount rate	0.25%/(0.25)%	\$(2)/\$1
Inflation rate	0.25%/(0.25)%	\$2/\$ (2)

## Income Tax Uncertainties

Significant management judgment is required in developing KU's provision for income taxes primarily due to the uncertainty related to tax positions taken or expected to be taken in tax returns and the determination of deferred tax assets, liabilities and valuation allowances.

Significant management judgment is required to determine the amount of benefit recognized related to an uncertain tax position. KU evaluates its tax positions following a two-step process. The first step requires an entity to determine whether, based on the technical merits supporting a particular tax position, it is more likely than not (greater than a 50% chance) that the tax position will be sustained. This determination assumes that the relevant taxing authority will examine the tax position and is aware of all the relevant facts surrounding the tax position. The second step requires an entity to recognize in the financial statements the benefit of a tax position that meets the more-likely-than-not recognition criterion. The benefit recognized is measured at the largest amount of benefit that has a likelihood of realization, upon settlement, that exceeds 50%. KU's management considers a number of factors in assessing the benefit to be recognized, including negotiation of a settlement.

On a quarterly basis, KU reassesses its uncertain tax positions by considering information known at the reporting date. Based on management's assessment of new information, KU may subsequently recognize a tax benefit for a previously unrecognized tax position, de-recognize a previously recognized tax position or re-measure the benefit of a previously recognized tax position. The amounts ultimately paid upon resolution of issues raised by taxing authorities may differ materially from the amounts accrued and may materially impact KU financial statements in the future.

The balance sheet classification of unrecognized tax benefits and the need for valuation allowances to reduce deferred tax assets also require significant management judgment. KU classifies unrecognized tax benefits as current, to the extent management expects to settle an uncertain tax position, by payment or receipt of cash, within one year of the reporting date. Valuation allowances are initially recorded and reevaluated each reporting period by assessing the likelihood of the ultimate realization of a deferred tax asset. Management considers a number of factors in assessing the realization of a deferred tax asset, including the reversal of temporary differences, future taxable income and ongoing prudent and feasible tax planning strategies. Any tax planning strategy utilized in this assessment must meet the recognition and measurement criteria utilized by KU to account for an uncertain tax position. See Note 10, Income Taxes, for the required disclosures.

At December 31, 2010, KU's existing reserve exposure to either increases or decreases in unrecognized tax benefits during the next 12 months is less than \$1 million. This change could result from subsequent recognition, de-recognition and/or changes in the measurement of uncertain tax positions. The events that could cause these changes are direct settlements with taxing authorities, litigation, legal or administrative guidance by relevant taxing authorities and the lapse of an applicable statute of limitations.

## Purchase Price Allocation

On November 1, 2010, PPL completed the acquisition of KU's parent. In accordance with accounting guidance on business combinations, the identifiable assets acquired and the liabilities assumed were measured at fair value at the acquisition date. Fair value is defined as the price that would be received to

sell an asset or paid to transfer a liability in an orderly transaction between market participants. The excess of the purchase price over the estimated fair value of the identifiable net assets is recorded as goodwill.

The determination and allocation of fair value to the identifiable assets acquired and liabilities assumed was based on various assumptions and valuation methodologies requiring considerable management judgment, including estimates based on key assumptions of the acquisition and historical and current market data. The most significant variables in these valuations were the discount rates, the number of years on which to base cash flow projections, as well as the assumptions and estimates used to determine cash inflows and outflows. Although the assumptions applied were reasonable based on information available at the date of acquisition, actual results may differ from the forecasted amounts and the difference could be material.

For purposes of measuring the fair value of the majority of property, plant and equipment and regulatory assets acquired and regulatory liabilities assumed, KU determined that fair value was equal to net book value at the acquisition date because KU's operations are conducted in a regulated environment and the regulatory commissions allow for earning a rate of return on the book value of a majority of the regulated asset bases at rates determined to be fair and reasonable. As there is no current prospect for deregulation in KU's operating area, it is expected that these operations will remain in a regulated environment for the foreseeable future, therefore management has concluded that the use of these assets in the regulatory environment represents their highest and best use and a market participant would measure the fair value of these assets using the regulatory rate of return as the discount rate, thus resulting in fair value equal to book value.

The fair value of intangible assets and liabilities (e.g. contracts that have favorable or unfavorable terms relative to market), including coal contracts and power purchase agreements, as well as emission allowances, have been reflected on the Balance Sheets with offsetting regulatory assets or liabilities. Prior to the acquisition, KU recovered the cost of the coal contracts, power purchases and emission allowances and this rate treatment will continue after the acquisition. As a result, management believes the regulatory assets and liabilities created to offset the fair value adjustments meet the recognition criteria established by existing accounting guidance and eliminate any ratemaking impact of the fair value adjustments. KU's customer rates will continue to reflect these items (e.g. coal, purchased power, emission allowances) at their original contracted prices.

KU also considered whether a separate fair value should be assigned to KU's rights to operate within its various electric service areas but concluded that these rights only provided the opportunity to earn a regulated return and barriers to market entry, which in management's judgment is not considered a separately identifiable intangible asset under applicable accounting guidance; rather, it is considered going-concern value, or goodwill.

See Note 2, Acquisition by PPL and Note 7, Goodwill and Intangible Assets, for further information.

#### New Accounting Guidance

Recent accounting pronouncements affecting KU are detailed in Note 1, Summary of Significant Accounting Policies.

### Other Information

PPL's Audit Committee has approved the audit fees and audit-related services. The audit-related services include services in connection with regulatory filings, reviews of offering documents and registration statements and internal control reviews.

## **Management's Report of Internal Controls Over Financial Reporting**

Through December 31, 2010, the Company was not subject to the internal control and other requirements of the Sarbanes-Oxley Act of 2002 and associated rules (the "Act") and consequently is not required to evaluate the effectiveness of its internal control over financial reporting pursuant to Section 404 of the Act. However, management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process affected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. A company's internal control over financial reporting includes those policies and procedures that pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2010, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control – Integrated Framework*. Management has concluded that, as of December 31, 2010, the Company's internal control over financial reporting was effective based on those criteria.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2010, has been audited by PricewaterhouseCoopers LLP, an independent accounting firm, as stated in its report which is included herein.



**Kentucky Utilities Company**  
**Statements of Income**  
(millions)

	Successor	Predecessor		
	November 1 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31	
			2009	2008
Operating revenues (Note 15) .....	\$ 263	\$ 1,248	\$ 1,355	\$ 1,405
Operating expenses:				
Fuel for electric generation .....	78	417	434	513
Power purchased (Notes 13 and 15).....	28	147	199	221
Other operation and maintenance expenses.....	66	280	320	275
Depreciation and amortization .....	<u>26</u>	<u>119</u>	<u>133</u>	<u>136</u>
Total operating expenses .....	<u>198</u>	<u>963</u>	<u>1,086</u>	<u>1,145</u>
Operating income .....	65	285	269	260
Equity in earnings of unconsolidated venture (Note 1) .....	-	3	1	30
Interest expense (Notes 11 and 12) .....	8	6	6	14
Interest expense to affiliated companies (Notes 11, 12 and 15).....	2	62	69	58
Other income (expense) - net .....	<u>-</u>	<u>(2)</u>	<u>5</u>	<u>8</u>
Income before income taxes .....	55	218	200	226
Income tax expense (Note 10).....	<u>20</u>	<u>78</u>	<u>67</u>	<u>68</u>
Net income.....	<u>\$ 35</u>	<u>\$ 140</u>	<u>\$ 133</u>	<u>\$ 158</u>

The accompanying notes are an integral part of these financial statements.

**Kentucky Utilities Company**  
**Statements of Retained Earnings**  
(millions)

	Successor	Predecessor		
	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31, 2009      2008	
Balance at beginning of period.....	\$ 1,418	\$ 1,328	\$ 1,195	\$ 1,037
Effect of PPL acquisition.....	<u>(1,418)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Balance at November 1, 2010.....	-	1,328	1,195	1,037
Net income .....	35	140	133	158
Cash dividends declared (Note 15).....	<u>-</u>	<u>(50)</u>	<u>-</u>	<u>-</u>
Balance at end of period .....	<u>\$ 35</u>	<u>\$ 1,418</u>	<u>\$ 1,328</u>	<u>\$ 1,195</u>

The accompanying notes are an integral part of these financial statements.

**Kentucky Utilities Company**  
**Statements of Comprehensive Income**  
(millions)

	Successor	Predecessor		
	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31, <u>2009</u> <u>2008</u>	
Net income .....	\$ 35	\$ 140	\$ 133	\$ 158
Equity investee's other comprehensive loss, net of tax expense of \$0, \$1, \$0 and \$0, respectively (Note 1).....	<u>-</u>	<u>(2)</u>	<u>-</u>	<u>-</u>
Comprehensive income .....	<u>\$ 35</u>	<u>\$ 138</u>	<u>\$ 133</u>	<u>\$ 158</u>

The accompanying notes are an integral part of these financial statements.

**Kentucky Utilities Company**  
**Balance Sheets**  
(millions)

	Successor December 31, 2010	Predecessor December 31, 2009
Assets		
Current assets:		
Cash and cash equivalents.....	\$ 3	\$ 2
Accounts receivable (less allowance for doubtful accounts: 2010, \$6; 2009, \$3):		
Customer .....	90	79
Affiliated companies .....	12	9
Other.....	20	18
Unbilled revenues.....	89	76
Fuel, materials and supplies:		
Fuel (predominantly coal) .....	95	98
Other materials and supplies .....	41	39
Other intangible assets .....	22	-
Regulatory assets (Note 3) .....	9	32
Prepayments and other current assets.....	15	13
Total current assets .....	396	366
Investment in unconsolidated venture (Note 1).....	30	12
Property, plant and equipment:		
Regulated utility plant – electric .....	3,630	4,892
Accumulated depreciation.....	(14)	(1,838)
Net regulated utility plant.....	3,616	3,054
Construction work in progress .....	955	1,257
Property, plant and equipment – net.....	4,571	4,311
Deferred debits and other assets:		
Regulatory assets (Notes 3 and 9):		
Pension benefits .....	117	105
Other regulatory assets.....	105	117
Goodwill (Notes 2 and 7).....	607	-
Other intangibles assets (Notes 2 and 7) .....	175	-
Cash surrender value of key man life insurance.....	39	38
Other assets .....	19	7
Total deferred debits and other assets.....	1,062	267
Total assets .....	\$ 6,059	\$ 4,956

The accompanying notes are an integral part of these financial statements.

**Kentucky Utilities Company**  
**Balance Sheets (continued)**  
(millions)

	Successor December 31, 2010	Predecessor December 31, 2009
Liabilities and Equity		
Current liabilities:		
Current portion of long-term debt (Note 11).....	\$ -	\$ 228
Current portion of long-term debt to affiliated company (Notes 11 and 15) .....	-	33
Notes payable to affiliated companies (Notes 12 and 15).....	10	45
Accounts payable .....	67	107
Accounts payable to affiliated companies (Note 15) .....	45	88
Accrued taxes .....	25	14
Customer deposits .....	23	22
Regulatory liabilities (Note 3).....	41	4
Accrued interest .....	8	1
Employee accruals.....	15	13
Other current liabilities.....	18	14
Total current liabilities .....	252	569
Long-term debt:		
Long-term bonds (Note 11).....	1,841	123
Long-term debt to affiliated company (Notes 11 and 15).....	-	1,298
Total long-term debt .....	1,841	1,421
Deferred credits and other liabilities:		
Deferred income taxes (Note 10) .....	376	336
Accumulated provision for pensions (Note 9) .....	113	160
Investment tax credits (Note 10) .....	104	104
Asset retirement obligations (Notes 3 and 4) .....	54	34
Regulatory liabilities (Note 3):		
Accumulated cost of removal of utility plant.....	348	335
Other regulatory liabilities .....	186	25
Other liabilities .....	94	20
Total deferred credits and other liabilities.....	\$ 1,275	\$ 1,014

The accompanying notes are an integral part of these financial statements.

**Kentucky Utilities Company**  
 Balance Sheets (continued)  
 (millions)

	Successor December 31, 2010	Predecessor December 31, 2009
Equity:		
Common stock, without par value – authorized 80,000,000 shares, outstanding 37,817,878 shares .....	\$ 308	\$ 308
Additional paid-in capital .....	2,348	316
Retained earnings:		
Retained earnings .....	35	1,318
Undistributed earnings from unconsolidated venture .....	<u>-</u>	<u>10</u>
Total equity .....	<u>2,691</u>	<u>1,952</u>
Total liabilities and equity .....	<u>\$ 6,059</u>	<u>\$ 4,956</u>

The accompanying notes are an integral part of these financial statements.

**Kentucky Utilities Company**  
**Statements of Cash Flows**  
(millions)

	Successor	Predecessor		
	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31, 2009      2008	
Cash flows from operating activities:				
Net income .....	\$ 35	\$ 140	\$ 133	\$ 158
Adjustments to reconcile net income to net cash provided by (used in) operating activities: .....				
Depreciation and amortization .....	26	119	133	136
Deferred income taxes – net.....	4	23	50	(13)
Investment tax credits (Note 10).....	-	-	24	25
Provision for pension and postretirement benefits.....	5	13	26	10
Other – net.....	2	(3)	-	1
Change in current assets and liabilities:				
Accounts receivable .....	(15)	13	11	13
Unbilled revenues.....	(32)	19	(15)	(1)
Fuel, materials and supplies .....	5	(6)	(28)	(33)
Regulatory assets.....	(2)	19	-	-
Other current assets .....	9	(9)	(3)	(1)
Accounts payable .....	9	(17)	(32)	2
Accounts payable to affiliated companies .....	(41)	46	29	7
Accrued taxes .....	15	(5)	6	8
Regulatory liabilities .....	12	3	-	-
Other current liabilities.....	(2)	2	2	(3)
Pension and postretirement funding (Note 9).....	(2)	(18)	(20)	(5)
Storm restoration regulatory asset (Note 3).....	-	-	(57)	(2)
Other regulatory assets.....	1	8	-	-
Other regulatory liabilities .....	-	(10)	-	-
Other – net.....	(1)	7	(6)	(10)
Net cash provided by (used in) operating activities .....	<u>28</u>	<u>344</u>	<u>253</u>	<u>292</u>
Cash flows from investing activities:				
Construction expenditures.....	(87)	(292)	(516)	(686)
Purchases of assets from affiliate.....	-	(48)	-	(10)
Change in restricted cash.....	-	-	9	1
Net cash provided by (used in) investing activities .....	<u>\$ (87)</u>	<u>\$ (340)</u>	<u>\$ (507)</u>	<u>\$ (695)</u>

The accompanying notes are an integral part of these financial statements.

**Kentucky Utilities Company**  
**Statements of Cash Flows (continued)**  
(millions)

	Successor	Predecessor		
	November 1, 2010 through December 31, 2010,	January 1, 2010 through October 31, 2010	Year Ended December 31, 2009      2008	
<b>Cash flows from financing activities:</b>				
Issuance of bonds (Note 11).....	\$ 1,489	\$ -	\$ -	\$ 77
Short-term borrowings from affiliated company – net (Note 12).....	(83)	48	29	(7)
Other borrowings from affiliated companies (Note 11).....	1,331	-	150	250
Repayments on other borrowings from affiliated companies (Note 11).....	(1,331)	-	-	-
Repayments to E.ON affiliate (Note 11)...	(1,331)	-	-	-
Debt issuance costs.....	(17)	-	-	-
Retirement of pollution control bonds.....	-	-	-	(60)
Acquisition of outstanding bonds.....	-	-	-	(80)
Reissuance of reacquired bonds.....	-	-	-	63
Retirement of reacquired bonds.....	-	-	-	17
Payment of dividends.....	-	(50)	-	-
Capital contribution (Note 15).....	-	-	75	145
Net cash provided by (used in) financing activities.....	<u>58</u>	<u>(2)</u>	<u>254</u>	<u>405</u>
Change in cash and cash equivalents.....	(1)	2	-	2
Cash and cash equivalents at beginning of period.....	<u>4</u>	<u>2</u>	<u>2</u>	<u>-</u>
Cash and cash equivalents at end of period...	<u>\$ 3</u>	<u>\$ 4</u>	<u>\$ 2</u>	<u>\$ 2</u>
<b>Supplemental disclosures of cash flow information:</b>				
Cash paid (received) during the year for:				
Interest – net of amount capitalized .....	\$ 22	\$ 62	\$ 70	\$ 66
Income taxes – net.....	(12)	74	(9)	46

The accompanying notes are an integral part of these financial statements.



**Kentucky Utilities Company**  
**Statements of Capitalization**  
(millions)

	Successor December 31, 2010	Predecessor December 31, 2009
Long-term debt (Note 11):		
Pollution control series:		
Mercer Co. 2000 Series A, due May 1, 2023, variable %.....	\$ 13	\$ 13
Carroll Co. 2007 Series A, due February 1, 2026, 5.75%.....	18	18
Carroll Co. 2002 Series A, due February 1, 2032, variable %.....	21	21
Carroll Co. 2002 Series B, due February 1, 2032, variable %.....	2	2
Muhlenberg Co. 2002 Series A, due February 1, 2032, variable %.	2	2
Mercer Co. 2002 Series A, due February 1, 2032, variable %.....	8	8
Carroll Co. 2008 Series A, due February 1, 2032, variable %.....	78	78
Carroll Co. 2002 Series C, due October 1, 2032, variable %.....	96	96
Carroll Co. 2006 Series B, due October 1, 2034, variable %.....	54	54
Trimble Co. 2007 Series A, due March 1, 2037, 6.0%.....	9	9
Carroll Co. 2004 Series A, due October 1, 2034, variable % .....	<u>50</u>	<u>50</u>
Total pollution control series.....	<u>351</u>	<u>351</u>
First mortgage bonds:		
First mortgage bond 2015 Series, due November 1, 2015, 1.625% .....	250	-
First mortgage bond 2020 Series, due November 1, 2020, 3.25% .....	500	-
First mortgage bond 2040 Series, due November 1, 2040, 5.125% .....	<u>750</u>	<u>-</u>
Total first mortgage bonds.....	<u>\$ 1,500</u>	<u>\$ -</u>

The accompanying notes are an integral part of these financial statements.

**Kentucky Utilities Company**  
**Statements of Capitalization (continued)**  
(millions)

	Successor December 31, 2010	Predecessor December 31, 2009
Long-term debt to affiliated company:		
Due November 24, 2010, 4.24%, unsecured.....	\$ -	\$ 33
Due January 16, 2012, 4.39%, unsecured .....	-	50
Due April 30, 2013, 4.55%, unsecured .....	-	100
Due August 15, 2013, 5.31%, unsecured .....	-	75
Due December 19, 2014, 5.45%, unsecured .....	-	100
Due July 8, 2015, 4.735%, unsecured.....	-	50
Due December 21, 2015, 5.36%, unsecured .....	-	75
Due October 25, 2016, 5.675%, unsecured.....	-	50
Due April 24, 2017, 5.28%, unsecured .....	-	50
Due June 20, 2017, 5.98%, unsecured .....	-	50
Due July 25, 2018, 6.16%, unsecured.....	-	50
Due August 27, 2018, 5.645%, unsecured .....	-	50
Due December 17, 2018, 7.035%, unsecured .....	-	75
Due July 29, 2019, 4.81%, unsecured.....	-	50
Due October 25, 2019, 5.71%, unsecured.....	-	70
Due November 25, 2019, 4.445%, unsecured.....	-	50
Due February 7, 2022, 5.69%, unsecured .....	-	53
Due May 22, 2023, 5.85%, unsecured .....	-	75
Due September 14, 2028, 5.96%, unsecured .....	-	100
Due June 23, 2036, 6.33%, unsecured .....	-	50
Due March 30, 2037, 5.86%, unsecured .....	-	75
Total long-term debt to affiliated company .....	-	1,331
Total long-term debt outstanding .....	1,851	1,682
Purchase accounting adjustments and discounts.....	(10)	-
Less current portion of long-term debt.....	-	261
Long-term debt.....	<u>\$ 1,841</u>	<u>\$ 1,421</u>

The accompanying notes are an integral part of these financial statements.

**Kentucky Utilities Company**  
**Statements of Capitalization (continued)**  
(millions)

	Successor December 31, 2010	Predecessor December 31, 2009
Common equity:		
Common stock, without par value – authorized 80,000,000 shares, outstanding 37,817,878 shares.....	\$ 308	\$ 308
Additional paid-in-capital .....	2,348	316
Retained earnings:		
Retained earnings.....	35	1,318
Undistributed subsidiary earnings.....	<u>-</u>	<u>10</u>
Total retained earnings .....	<u>35</u>	<u>1,328</u>
Total common equity.....	<u>2,691</u>	<u>1,952</u>
Total capitalization .....	<u>\$ 4,532</u>	<u>\$ 3,373</u>

The accompanying notes are an integral part of these financial statements.

**Kentucky Utilities Company**  
Notes to Financial Statements

**Note 1 - Summary of Significant Accounting Policies**

**General**

Terms and abbreviations are explained in the index of abbreviations. Dollars are in millions unless otherwise noted.

Business

KU, incorporated in Kentucky in 1912 and in Virginia in 1991, is a regulated utility engaged in the generation, transmission, distribution and sale of electric energy in Kentucky, Virginia and Tennessee. KU provides electric service to approximately 514,000 customers in 77 counties in central, southeastern and western Kentucky, to approximately 30,000 customers in five counties in southwestern Virginia and less than ten customers in Tennessee. KU's service area covers approximately 6,600 noncontiguous square miles. Approximately 98% of the electricity generated by KU is produced by its coal-fired electric generating stations. The remainder is generated by natural gas and oil fueled CTs and a hydroelectric power plant. In Virginia, KU operates under the name Old Dominion Power Company. KU also sells wholesale electric energy to 12 municipalities.

On November 1, 2010, KU became an indirect wholly owned subsidiary of PPL, when PPL acquired all of the outstanding limited liability company interests in the Company's direct parent, LKE, from E.ON US Investments Corp. LKE, a Kentucky limited liability company, also owns the affiliate, LG&E, a regulated utility engaged in the generation, transmission, distribution and sale of electric energy and distribution and sale of natural gas in Kentucky. Following the acquisition, the Company's business has not changed. KU and LG&E are continuing as subsidiaries of LKE, which is now an intermediary holding company in the PPL group of companies.

Headquartered in Allentown, Pennsylvania, PPL is an energy and utility holding company that was incorporated in 1994. Through its subsidiaries, PPL owns or controls about 19,000 megawatts of generating capacity in the U.S., sells energy in key U.S. markets and delivers electricity and natural gas to about 5.3 million customers in the U.S. and the U.K.

Basis of Accounting

KU's basis of accounting incorporates the business combinations guidance of the FASB ASC as of the date of the acquisition, which requires the recognition and measurement of identifiable assets acquired and liabilities assumed at fair value as of the acquisition date. KU's financial statements and accompanying footnotes have been segregated to present pre-acquisition activity as the Predecessor and post-acquisition activity as the Successor. Predecessor covers the time period prior to November 1, 2010. Successor covers the time period after October 31, 2010. Certain accounting and presentation methods were changed to acceptable alternatives to conform to PPL accounting policies, which are discussed below, and the cost basis of certain assets and liabilities were changed as of November 1, 2010, as a result of the application of push-down accounting. Consequently, the financial position, results of operations and cash flows for the Predecessor period are not comparable to the Successor period.

Despite the separate presentation, the core operations of the Company have not changed. See Note 2, Acquisition by PPL, for information regarding the acquisition and the purchase accounting adjustments.

### Changes in Classification

Certain reclassification entries have been made to the Predecessor's previous years' financial statements to conform to the 2010 presentation with no impact on net assets, liabilities and capitalization or previously reported net income and cash flows. These reclassifications mainly consist of those necessary to identify amounts for prior periods that are separately disclosed in the financial statements.

### Regulatory Accounting

KU is a cost-based rate-regulated utility. As a result, the financial statements reflect the effects of regulatory actions. Regulatory assets are recognized for the effect of transactions or events where future recovery is probable in regulated customer rates. The effect of such accounting is to defer certain or qualifying costs that would otherwise be charged to expense. Likewise, regulatory liabilities may be recognized for obligations expected to be returned through future regulated customer rates. The effect of such transactions or events would otherwise be reflected as income, or, in certain cases, regulatory liabilities are recorded based on the understanding with the regulator that current rates are being set to recover costs that are expected to be incurred in the future. The regulated entity is accountable for any amounts charged pursuant to such rates and not yet expended for the intended purpose. Offsetting regulatory assets or liabilities for fair value purchase accounting adjustments have also been recorded to eliminate any ratemaking impact of the fair value adjustments. The accounting for regulatory assets and liabilities is based on specific ratemaking decisions or precedent for each transaction or event as prescribed by the FERC, Kentucky Commission, Virginia Commission or the Tennessee Regulatory Authority. See Note 3, Rates and Regulatory Matters, for additional detail regarding regulatory assets and liabilities.

### Management's Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported assets and liabilities, the disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### **Derivative Financial Instruments**

KU enters into energy trading contracts to manage price risk and to maximize the value of power sales from the physical assets it owns. The energy trading contracts are non-hedging derivatives and the change in value is recognized in earnings on a mark-to-market basis. The Predecessor and Successor presentation are both appropriate under GAAP. The Predecessor and Successor determine the classification of energy trading contracts based on the settlement date of the individual contracts. Energy trading contracts classified as current are recognized in "Prepayments and other current assets" or "Other current liabilities" on the Balance Sheets. Energy trading contracts classified as non-current are recognized in "Other assets" or "Other liabilities" on the Balance Sheets. Cash inflows and outflows

related to derivative instruments are included as a component of operating activity on the Statements of Cash Flows, due to the underlying nature of the hedged items.

The Company does not net collateral against derivative instruments.

See Note 5, Derivative Financial Instruments, and Note 6, Fair Value Measurements, for further information on derivative instruments.

### Revenue and Accounts Receivable

The operating revenues line item in the Statements of Income contains revenues from the following:

	Successor	Predecessor		
	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31,	
			2009	2008
Residential	\$ 106	\$ 440	\$ 480	\$ 462
Industrial and commercial	117	588	637	636
Municipals	15	88	91	92
Other retail	20	114	118	108
Wholesale	5	18	29	107
	\$ 263	\$ 1,248	\$ 1,355	\$ 1,405

### Revenue Recognition

Revenues are recorded based on service rendered to customers through month-end. Operating revenues are recorded based on energy deliveries through the end of the calendar month. Unbilled retail revenues result because customers' meters are read and bills are rendered throughout the month, rather than all being read at the end of the month. Unbilled revenues for a month are calculated by multiplying an estimate of unbilled kWh by the estimated average cents per kWh.

### Accounts Receivable

Accounts receivable are reported in the Balance Sheets at the gross outstanding amount adjusted for an allowance for doubtful accounts.

### Allowance for Doubtful Accounts

The allowance for doubtful accounts included in "Accounts receivable – customer" is based on the ratio of the amounts charged-off during the last twelve months to the retail revenues billed over the same period, multiplied by the retail revenues billed over the last four months. Accounts with no payment activity are charged-off after four months, although collection efforts continue thereafter. The allowance for doubtful accounts included in "Accounts receivable – other" is composed of accounts aged more than four months. Accounts are written off as management determines them uncollectible.

The changes in the allowance for doubtful accounts were:

	Successor	Predecessor		
	December 31, 2010	October 31, 2010	December 31, 2009	December 31, 2008
Balance at beginning of period (a) \$	-	\$ 3	\$ 3	\$ 2
Charged to income	1	(6)	(4)	(2)
Charged to balance sheets	5	6	4	3
Balance at end of period	<u>\$ 6</u>	<u>\$ 3</u>	<u>\$ 3</u>	<u>\$ 3</u>

(a) Successor beginning of period reflects revaluation of accounts receivable due to purchase accounting.

## Cash

### Cash Equivalents

All highly liquid investments with an original maturity of three months or less are considered to be cash equivalents.

### Restricted Cash

Bank deposits and other cash equivalents that are restricted by agreement or that have been clearly designated for a specific purpose are classified as restricted cash. The change in restricted cash is reported as an investing activity on the Statements of Cash Flows. On the Balance Sheets, restricted cash is included in "Prepayments and other current assets". For KU, the December 31, 2010, balance of restricted cash was less than \$1 million.

## Fair Value Measurements

KU values certain financial assets and liabilities at fair value. Generally, the most significant fair value measurements relate to derivative assets and liabilities, investments in securities including investments in the pension and postretirement benefit plans and cash and cash equivalents. KU uses, as appropriate, a market approach (generally, data from market transactions), an income approach (generally, present value techniques) and/or a cost approach (generally, replacement cost) to measure the fair value of an asset or liability. These valuation approaches incorporate inputs such as observable, independent market data and/or unobservable data that management believes are predicated on the assumptions that market participants would use to price an asset or liability. These inputs may incorporate, as applicable, certain risks such as nonperformance risk, which includes credit risk.

KU prioritizes fair value measurements for disclosure by grouping them into one of three levels in the fair value hierarchy. The highest priority is given to measurements using level 1 inputs. The appropriate level assigned to a fair value measurement is based on the lowest level input that is significant to the fair value measurement in its entirety. The three levels of the fair value hierarchy are as follows:

- Level 1 - Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 - Other inputs that are directly or indirectly observable in the marketplace.
- Level 3 - Unobservable inputs which are supported by little or no market activity.

Assessing the significance of a particular input requires judgment that considers factors specific to the asset or liability. As such, KU's assessment of the significance of a particular input may affect how the assets and liabilities are classified within the fair value hierarchy. See Note 5, Derivatives Financial Instruments, and Note 6, Fair Value Measurements, for further information on fair value measurements.

## Investments

### Equity Method Investment

KU's equity method investment, included in "Investment in unconsolidated venture" on the Balance Sheets, consists of its investment in EEI. KU owns 20% of the common stock of EEI, which owns and operates a 1,002 Mw summer capacity coal-fired plant and a 74 Mw summer capacity natural gas facility in southern Illinois. Through a power marketer affiliated with its majority owner, EEI sells its output to third parties. Although KU holds investment interest in EEI, it is not the primary beneficiary and is therefore not consolidated into the Company's financial statements. KU's investment in EEI is accounted for under the equity method of accounting and as of December 31, 2010 and 2009, totaled \$30 million and \$12 million, respectively. KU's direct exposure to loss as a result of its involvement with EEI is generally limited to the value of its investment. See Note 2, Acquisition by PPL, for further discussion regarding purchase accounting adjustments recognized for KU's investment in EEI.

The results of operations and financial position of EEI, KU's equity method investment, are summarized below.

Condensed income statement information for the years ended December 31 is as follows:

	2010 <u>(unaudited)</u>	<u>2009</u>	<u>2008</u>
Net sales	\$ 343	\$ 297	\$ 514
Net income	16	10	142
KU's equity in earnings of EEI	3	1	30



Condensed balance sheet information as of December 31 is as follows:

	2010 (unaudited)	2009
Current assets	\$ 62	\$ 84
Long-lived assets	181	178
Total assets	<u>\$ 243</u>	<u>\$ 262</u>
Current liabilities	\$ 113	\$ 166
Long-term liabilities	72	50
Equity	<u>58</u>	<u>46</u>
Total liabilities and equity	<u>\$ 243</u>	<u>\$ 262</u>

#### Cost Method Investment

KU's cost method investment, included in "Investments in unconsolidated venture" on the Balance Sheets, consists of the Company's investment in OVEC. KU and 11 other electric utilities are owners of OVEC, which is located in Piketon, Ohio. OVEC owns and operates two coal-fired power plants, Kyger Creek Station in Ohio and Clifty Creek Station in Indiana with combined nameplate generating capacities of 2,390 Mw. OVEC's power is currently supplied to KU and 13 other companies affiliated with the various owners. Pursuant to current contractual agreements, KU owns 2.5% of OVEC's common stock and is contractually entitled to 2.5% of OVEC's output. Based on nameplate generating capacity, this would be approximately 60 Mw.

As of December 31, 2010 and 2009, KU's investment in OVEC totaled less than \$1 million. KU is not the primary beneficiary of OVEC; therefore, it is not consolidated into the Company's financial statements and is accounted for under the cost method of accounting. The direct exposure to loss as a result of the Company's involvement with OVEC is generally limited to the value of its investment; however, KU may be conditionally responsible for a pro-rata share of certain OVEC obligations. See Note 2, Acquisition by PPL, and Note 13, Commitments and Contingencies, for further discussion regarding purchase accounting adjustments recognized, and KU's ownership interest and power purchase rights.

#### **Long-Lived and Intangible Assets**

##### Regulated Utility Plant

Regulated utility plant was stated at original cost for the Predecessor and adjusted to the net book value on November 1, 2010, the acquisition date, for the Successor. KU determined that fair value was equal to net book value at the acquisition date since KU's operations are conducted in a regulated environment. Original cost includes payroll-related costs such as taxes, fringe benefits and administrative and general costs. Construction work in progress has been included in the rate base for determining retail customer rates. KU has not recorded significant allowance for funds used during construction in accordance with FERC.

The cost of plant retired or disposed of in the normal course of business is deducted from plant accounts and such cost is charged to the reserve for depreciation. When complete operating units are disposed of,

appropriate adjustments are made to the reserve for depreciation and gains and losses, if any, are recognized.

### Capitalized Software Cost

Included in “Property, plant and equipment” on the Balance Sheets are capitalized costs of software projects that were developed or obtained for internal use. These capitalized costs are amortized ratably over the expected lives of the projects when they become operational, generally not to exceed five years. Following are capitalized software costs and the accumulated amortization:

Successor		Predecessor	
December 31, 2010		December 31, 2009	
Carrying Amount	Accumulated Amortization (a)	Carrying Amount	Accumulated Amortization
\$ 40	\$ 1	\$ 52	\$ 13

- (a) The accumulated amortization as of November 1, 2010, was netted against the carrying amount of the software as the fair value was determined to be equal to net book value for property, plant and equipment.

Amortization expense of capitalized software costs was as follows:

Successor	Predecessor	
November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31, 2009
		2008
\$ 1	\$ 6	\$ 5

The amortization of capitalized software is included in “Depreciation and amortization” on the Statements of Income.

### Depreciation and Amortization

Depreciation is provided on the straight-line method over the estimated service lives of depreciable plant. The amounts provided as a percentage of depreciable plant were approximately:

Year	Percentage
2010	4.1%
2009	2.6%
2008	3.0%

Of the amount provided for depreciation, the following were related to the retirement, removal and disposal costs of long lived assets:

<u>Year</u>	<u>Percentage</u>
2010	0.6%
2009	0.4%
2008	0.5%

#### Goodwill, Intangible Assets and Asset Impairment

KU performs a quarterly review to determine if an impairment analyses is required for long-lived assets that are subject to depreciation or amortization. This review identifies changes in circumstances indicating that a long-lived asset's carrying value may not be recoverable. An impairment analysis will be performed if warranted, based on the review.

For a long-lived asset to be held and used, impairment exists when the carrying amount exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. If the asset is impaired, an impairment loss is recorded to adjust the asset's carrying amount to its fair value.

KU, as the result of PPL's acquisition of LKE, recorded the fair value of its coal contracts, emission allowances, EEI investment and OVEC power purchase contract. The difference between the fair value and the cost for these assets is being amortized over their useful lives based upon the pattern in which the economic benefits of the intangible assets are consumed or otherwise used. When determining the useful life of an intangible asset, including intangible assets that are renewed or extended, KU considers the expected use of the asset, the expected useful life of other assets to which the useful life of the intangible asset may relate and legal, regulatory, or contractual provisions that may limit the useful life. See Note 2, Acquisition by PPL, for methods used to determine the long-lived intangible assets' fair values. See Note 7, Goodwill and Intangible Assets, for the fair value amounts and amortization periods. The current intangible assets and long-term intangible assets are included in "Other intangible assets" on the Balance Sheets.

The Predecessor reported emission allowances in "Other materials and supplies" on the Balance Sheets. The emission allowances were not amortized; rather, they were expensed when consumed. The Predecessor did not recognize the coal contracts or the OVEC power purchase contract as these intangible assets were not derivatives.

In connection with PPL's acquisition of LKE, KU recorded goodwill on November 1, 2010. Goodwill represents the excess of the purchase price paid over the estimated fair value of the assets acquired and liabilities assumed in the acquisition of a business. Goodwill is tested annually for impairment during the fourth quarter and more frequently if management determines that a triggering event may have occurred that would more likely than not reduce the fair value of an operating unit below its carrying value. Goodwill impairment charges are not subject to rate recovery. See Note 7, Goodwill and Intangible Assets, for further discussion regarding the Company's goodwill and current test results.

### Asset Retirement Obligations

KU recognizes various legal obligations associated with the retirement of long-lived assets as liabilities in the financial statements. Initially this obligation is measured at fair value. An equivalent amount is recorded as an increase in the value of the capitalized asset and allocated to expense over the useful life of the asset. Until the obligation is settled, the liability is increased, through the recognition of accretion expense in the Statements of Income, for changes in the obligation due to the passage of time. An offsetting regulatory asset is recognized to reverse the depreciation and accretion expense related to the ARO such that there is no income statement impact. The regulatory asset is relieved when the ARO has been settled. Estimated ARO costs and settlement dates, which affect the carrying value of various AROs and the related assets, are reviewed periodically to ensure that any material changes are incorporated into the latest estimate of the obligations. See Note 4, Asset Retirement Obligations, for further information on AROs.

### **Defined Benefits**

KU employees benefit from both funded and unfunded retirement benefit plans. An asset or liability is recorded to recognize the funded status of all defined benefit plans with an offsetting entry to regulatory assets or regulatory liabilities. Consequently, the funded status of all defined benefit plans is fully recognized on the Balance Sheets.

The expected return on plan assets is determined based on the current level of expected return on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class is then weighted based on the current asset allocation.

The discount rate used for pensions, postretirement and post-employment plans by the Predecessor was determined using the Mercer Yield Curve. The expected return on assets assumption was 7.75%. Gains and losses in excess of 10% of the greater of the plan's projected benefit obligation or market value of assets were amortized on a straight-line basis over the average future service period of active participants. The market-related value of assets was equal to the fair market value of the assets.

The discount rate used by the Successor was determined by the Towers Watson Yield Curve based on the individual plan cash flows. The expected return on assets was reduced from 7.75% to 7.25%. The amortization period for the recognition of gains and losses for retirement plans was changed to reflect the Successor's amortization policy. Under the Successor's method, gains and losses in excess of 10% but less than 30% of the greater of the plan's projected benefit obligation or market-related value of assets, are amortized on a straight-line basis over the average future service period of active participants. Gains and losses in excess of 30% of the plan's projected benefit obligation or market-related value of assets are amortized on a straight-line basis over a period equal to one-half of the average future service period of active participants. The market-related value of assets for the qualified retirement plans will be equal to a five year smoothed asset value. Gains and losses in excess of the expected return will be phased-in over a five-year period, prospectively from November 1, 2010.

See Note 9, Pension and Other Postretirement Benefit Plans, for further information.

## **Other**

### Loss Accruals

Potential losses are accrued when information is available that indicates it is “probable” that a loss has been incurred, given the likelihood of uncertain future events, and the amount of the loss can be reasonably estimated. Accounting guidance defines “probable” as cases in which “the future event or events are likely to occur.” KU continuously assesses potential loss contingencies for environmental remediation, litigation claims, regulatory penalties and other events.

KU does not record the accrual of contingencies that might result in gains unless recovery is assured.

### Income Taxes

For the periods ended on or before October 31, 2010, KU was a subsidiary of E.ON U.S. and was part of E.ON U.S.’s direct parent’s, E.ON US Investments Corp., consolidated U.S. federal income tax return. On November 1, 2010, KU became a part of PPL’s consolidated U.S. federal income tax return.

Significant management judgment is required in developing KU’s provision for income taxes primarily due to the uncertainty related to tax positions taken or expected to be taken in tax returns and the determination of deferred tax assets, liabilities and valuation allowances.

KU evaluates tax positions following a two-step process. The first step requires an entity to determine whether, based on the technical merits supporting a particular tax position, it is more likely than not (greater than a 50% chance) that the tax position will be sustained. This determination assumes that the relevant taxing authority will examine the tax position and is aware of all the relevant facts surrounding the tax position. The second step requires an entity to recognize in the financial statements the benefit of a tax position that meets the more-likely-than-not recognition criterion. The benefit recognized is measured at the largest amount of benefit that has a likelihood of realization, upon settlement, that exceeds 50%. The amounts ultimately paid upon resolution of issues raised by taxing authorities may differ materially from the amounts accrued and may materially impact the financial statements of KU.

Deferred income taxes reflect the net future tax effects of temporary differences between the carrying amounts of assets and liabilities for accounting purposes and their basis for income tax purposes, as well as the tax effects of net operating losses and tax credit carryforwards.

KU records valuation allowances to reduce deferred tax assets to the amounts that are more likely than not to be realized. KU considers the reversal of temporary differences, future taxable income and ongoing prudent and feasible tax planning strategies in initially recording and subsequently reevaluating the need for valuation allowances. If KU determines that it is able to realize deferred tax assets in the future in excess of recorded net deferred tax assets, adjustments to the valuation allowances increase income by reducing tax expense in the period that such determination is made. Likewise, if KU determines that it is not able to realize all or part of net deferred tax assets in the future, adjustments to the valuation allowances would decrease income by increasing tax expense in the period that such determination is made.

The provision for KU's deferred income taxes for regulated assets and liabilities is based upon the ratemaking principles reflected in rates established by the regulators. The difference in the provision for deferred income taxes for regulated assets and liabilities and the amount that otherwise would be recorded under GAAP is deferred and included on the Balance Sheets in "Regulatory liabilities".

KU defers investment tax credits when the credits are utilized and amortizes the deferred amounts over the average lives of the related assets.

See Note 10, Income Taxes, for further discussion regarding income taxes.

#### Leases

KU evaluates whether arrangements entered into contain leases for accounting purposes.

#### Materials and Supplies

Fuel and other materials and supplies inventories are accounted for using the average-cost method.

#### Fuel Costs

The cost of fuel for electric generation is charged to expense as used. See Note 3, Rates and Regulatory Matters, for a description of the FAC.

#### Debt

The Company's long-term debt includes \$228 million of pollution control bonds, which are subject to tender for purchase at the option of the holder and to mandatory tender for purchase on the occurrence of certain events. The Successor has classified these bonds as long term because the Company has the intent and ability to utilize its \$400 million credit facility, which matures in December 2014, to fund any mandatory purchases. Predecessor classified these bonds as current portion of long-term debt due to the tender for purchase provisions. The Predecessor presentation and the Successor presentation are both appropriate under GAAP. See Note 11, Long-Term Debt, and Note 12, Notes Payable and Other Short-Term Obligations, for more information on the Company's debt and credit facilities.

#### Unamortized Debt Expense

Debt expense is capitalized and amortized over the lives of the related bond issues using the straight line method, which approximates the effective interest method. Depending on the type of expense, the Successor capitalized debt expenses in long-term other regulatory assets or long-term other assets to align with the term of the debt the expenses were related. The Predecessor capitalized debt expenses in current or long-term other regulatory assets or other current or long-term other assets based on the amount of expense expected to be recovered within the next year through rate recovery. Both the Predecessor and the Successor amortize debt expenses over the lives of the related bond issues. The Predecessor presentation and the Successor presentation are both appropriate under regulatory practices and GAAP.

## Recent Accounting Pronouncements

The following recent accounting pronouncement affected KU:

### Fair Value Measurements

In January 2010, the FASB issued guidance related to fair value measurement disclosures requiring separate disclosure of amounts of significant transfers in and out of level 1 and level 2 fair value measurements and separate information about purchases, sales, issuances and settlements within level 3 measurements. This guidance is effective for the interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about the roll-forward of activity in level 3 fair value measurements. Those disclosures are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. This guidance has no impact on the Company's results of operations, financial position, liquidity or disclosures.

### **Note 2 - Acquisition by PPL**

On November 1, 2010, PPL completed its acquisition of LKE and its subsidiaries. The push-down basis of accounting was used to record the fair value adjustments of assets and liabilities on LKE at the acquisition date. PPL paid a cash consideration for LKE and its subsidiaries of \$2,493 million as well as a capital contribution on November 1, 2010, of \$1,565 million; included within this was the consideration paid for KU of \$2,656 million. The allocation of the KU purchase price was based on the fair value of assets acquired and liabilities assumed.

The allocation of the purchase price to the fair value of assets acquired and liabilities assumed is as follows:

Current assets	\$	364
Investments		30
Property, plant and equipment		4,531
Other intangible assets		178
Regulatory and other non-current assets		274
Current liabilities (excluding current portion of long-term debt)		(367)
Affiliated debt		(1,331)
Debt (current and non-current)		(352)
Other non-current liabilities		(1,278)
Net identifiable assets acquired		2,049
Goodwill		607
Total purchase price	\$	<u>2,656</u>

Goodwill represents value paid for the rate regulated business of KU, which is located in a defined service area with a constructive regulatory environment, which provides for future investment, earnings and cash flow growth, as well as the talented and experienced workforce. KU's franchise values are being attributed to the going concern value of the business, and thus were recorded as goodwill rather than a separately identifiable intangible asset. None of the goodwill recognized is deductible for income tax purposes or included in regulated customer rates.

Adjustments to KU's assets and liabilities that contributed to goodwill were as follows:

The fair value adjustment on the EEI investment was calculated using the discounted cash flow valuation method. The result was an increase in KU's value of the investment in EEI; the fair value of EEI was calculated to be \$30 million and a fair value adjustment of \$18 million was recorded on KU. The fair value adjustment to EEI is amortized over the expected remaining useful life of plant and equipment at EEI, which is estimated to be over 20 years.

The pollution control bonds on KU had a fair value adjustment of \$1 million. All variable bonds were valued at par while the fixed rate bonds were valued with a yield curve based on average credit spreads for similar bonds.

As a result of the purchase accounting associated with the acquisition, the following items had a fair value adjustment but no effect on goodwill as the offset was either a regulatory asset or liability. The regulatory asset or liability has been recorded to eliminate any ratemaking impact of the fair value adjustments:

- The value of OVEC was determined to be \$39 million based upon an announced transaction by another owner. KU's stock was valued at less than \$1 million and the power purchase agreement has been valued at \$39 million. An intangible asset was recorded with the offset to regulatory liability and will be amortized using the units of production method until the power purchase agreement ends in March 2026.
- KU recorded an emission allowance intangible asset and regulatory liability as the result of adjusting the fair value of the emission allowances at KU. The emission allowance intangible of \$9 million represents allocated and purchased SO<sub>2</sub> and NO<sub>x</sub> emission allowances that are unused as of the valuation date or allocated for use in future years. KU had previously recorded emission allowances as other materials and supplies. To conform to PPL's accounting policy all emission allowances are now recorded as intangible assets. The emission allowance intangible asset is amortized as the emission allowances are consumed, which is expected to occur through 2040.
- KU recorded a coal contract intangible asset of \$145 million and non-current liability of \$22 million on the Balance Sheets. An offsetting regulatory asset was recorded for those contracts with unfavorable terms relative to market. An offsetting regulatory liability was recorded for those contracts that had favorable terms relative to market. All coal contracts held by KU, wherein it had entered into arrangements to buy amounts of coal at fixed prices from counterparties at a future date, were fair valued. The intangible assets and other liabilities, as well as the regulatory assets and liabilities, are being amortized over the same terms as the related contracts, which expire through 2016.

The fair value of intangible assets and liabilities (e.g. contracts that have favorable or unfavorable terms relative to market), including coal contracts and power purchase agreements, as well as emission allowances, have been reflected on the Balance Sheets with offsetting regulatory assets or liabilities. Prior to the acquisition, KU recovered the cost of the coal contracts, power purchases and emission allowances and this rate treatment will continue after the acquisition. As a result, management believes the regulatory assets and liabilities created to offset the fair value adjustments meet the recognition criteria established by existing accounting guidance and eliminate any ratemaking impact of the fair



value adjustments. KU's customer rates will continue to reflect these items (e.g. coal, purchased power, emission allowances) at their original contracted prices.

KU also considered whether a separate fair value should be assigned to KU's rights to operate within its various electric service areas but concluded that these rights only provided the opportunity to earn a regulated return and barriers to market entry, which in management's judgment is not considered a separately identifiable intangible asset under applicable accounting guidance; rather, it is considered going-concern value, or goodwill.

### **Note 3 - Rates and Regulatory Matters**

The Company is subject to the jurisdiction of the FERC, Kentucky Commission, Virginia Commission and the Tennessee Regulatory Authority in virtually all matters related to electric utility regulation and as such, its accounting is subject to the regulated operations guidance of the FASB ASC. Given its position in the marketplace and the status of regulation in Kentucky and Virginia, there are no plans or intentions to discontinue the application of the regulated operations guidance of the FASB ASC.

KU's Kentucky base rates are calculated based on a return on capitalization (common equity, long-term debt and notes payable) including certain regulatory adjustments to exclude non-regulated investments and environmental compliance plans recovered separately through the ECR mechanism. No regulatory assets or regulatory liabilities recorded at the time base rates were determined were excluded from the return on capitalization utilized in the calculation of Kentucky base rates. Therefore, a return is earned on all Kentucky regulatory assets existing at the time base rates were determined, except where such regulatory assets were offset by associated liabilities and thus, have no net impact on capitalization.

As a result of purchase accounting, certain fair value amounts, reflecting contracts that have favorable or unfavorable terms relative to market, were recorded on the Balance Sheets with offsetting regulatory assets or liabilities. Prior to the acquisition, KU recovered in customer rates the cost of the coal contracts, power purchases and emission allowances and this rate treatment will continue after the recognition criteria established by existing accounting guidance and eliminate any ratemaking impact of the fair value adjustments. KU's customer rates will continue to reflect these items (e.g. coal, purchased power, emission allowances) at their original contracted prices.

KU's Virginia base rates are calculated based on a return on rate base. All regulatory assets and liabilities are excluded from the return on rate base utilized in the calculation of Virginia base rates.

KU's wholesale requirements rates for municipal customers are calculated based on annual updates to a rate formula that utilizes a return on rate base. All regulatory assets and liabilities are excluded from the return on rate base utilized in the development of municipal rates.

#### 2010 Purchase and Sale Agreement with PPL

On April 28, 2010, E.ON U.S. announced that a Purchase and Sale Agreement (the "Agreement") had been entered into among E.ON US Investments Corp., PPL and E.ON.

The transaction was subject to customary closing conditions, including the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Act, receipt of required regulatory approvals

(including the FERC and state regulators in Kentucky, Virginia and Tennessee) and the absence of injunctions or restraints imposed by governmental entities.

Change of control and financing-related applications were filed on May 28, 2010 with the Kentucky Commission and on June 15, 2010 with the Virginia Commission and the Tennessee Regulatory Authority. An application with the FERC was filed on June 28, 2010. During the second quarter of 2010, a number of parties were granted intervenor status in the Kentucky Commission proceedings and data request filings and responses occurred. Early termination of the Hart-Scott-Rodino waiting period was received on August 2, 2010.

A hearing in the Kentucky Commission proceedings was held on September 8, 2010 at which time a unanimous settlement agreement was presented. In the settlement, KU committed that no base rate increases would take effect before January 1, 2013. The KU rate increases that took effect on August 1, 2010, were not impacted by the settlement. Under the terms of the settlement, KU retains the right to seek approval for the deferral of “extraordinary and uncontrollable costs.” Interim rate adjustments will continue to be permissible during that period for existing fuel, environmental and demand-side management cost trackers. The agreement also substitutes an acquisition savings shared deferral mechanism for the requirement that the Utilities file a synergies plan with the Kentucky Commission. This mechanism, which will be in place until the earlier of five years or the first day of the year in which a base rate increase becomes effective, permits KU to earn up to a 10.75% return on equity. Any earnings above a 10.75% return on equity will be shared with customers on a 50%/50% basis. On September 30, 2010, the Kentucky Commission issued an Order approving the transfer of ownership of KU via the acquisition of E.ON U.S. by PPL, incorporating the terms of the submitted settlement. On October 19, 2010 and October 21, 2010, respectively, Orders approving the acquisition of E.ON U.S. by PPL were received from the Virginia Commission and the Tennessee Regulatory Authority. The Commissions’ Orders contained a number of other commitments with regard to operations, workforce, community involvement and other matters.

In mid-September 2010, KU and other applicants in the FERC change of control proceeding reached an agreement with the protesters, whereby such protests have been withdrawn. The agreement, which was filed for consideration with the FERC, includes various conditional commitments, such as a continuation of certain existing undertakings with protesters in prior cases, an agreement not to terminate certain KU municipal customer contracts prior to January 2017, an exclusion of any transaction-related costs from wholesale energy and tariff customer rates to the extent that KU has agreed not to seek the same transaction-related costs from retail customers and agreements to coordinate with protesters in certain open or ongoing matters. A FERC Order approving the transaction was received on October 26, 2010 and the transaction was completed November 1, 2010.

#### 2010 Kentucky Rate Case

In January 2010, KU filed an application with the Kentucky Commission requesting an increase in electric base rates of approximately 12%, or \$135 million annually. In June 2010, KU and all of the intervenors, except the AG, agreed to stipulations providing for an increase in electric base rates of \$98 million annually and filed a request with the Kentucky Commission to approve such settlement. An Order in the proceeding was issued in July 2010, approving all the provisions in the stipulations, including a return on equity range of 9.75 – 10.75%. The new rates became effective on August 1, 2010.

### Virginia Rate Case

In June 2009, KU filed an application with the Virginia Commission requesting an increase in electric base rates for its Virginia jurisdictional customers in an amount of \$12 million annually or approximately 21%. The proposed increase reflected a proposed rate of return on rate base of 8.586% based on a return on equity of 12%. During December 2009, KU and the Virginia Commission Staff agreed to a Stipulation and Recommendation authorizing base rate revenue increases of \$11 million annually and a return on rate base of 7.846% based on a 10.5% return on common equity. In March 2010, the Virginia Commission issued an Order approving the stipulation, with the increased rates to be put into effect as of April 1, 2010. As part of the stipulation, KU refunded \$1 million in interim rate amounts in excess of the ultimate approved rates.

### FERC Wholesale Rate Case

In September 2008, KU filed an application with the FERC for increases in electric base rates applicable to wholesale power sales contracts or interchange agreements involving, collectively, twelve Kentucky municipalities. The application requested a shift from an all-in stated unit charge rate to an unbundled formula rate, including an annual adjustment mechanism. In 2009, the FERC issued an Order approving a settlement among the parties in the case, incorporating increases of approximately 3% from prior rates and a return on equity of 11%. In May 2010, KU submitted to the FERC the proposed current annual adjustments to the formula rates which incorporated certain proposed increases. Updated rates, including certain further adjustments from a review process involving wholesale requirements customers, became effective as of July 1, 2010, subject to certain review procedures by the wholesale requirements customers and the FERC.

By mutual agreement, the parties' settlement of the 2008 application left outstanding the issue of whether KU must allocate to the municipal customers a portion of renewable resources it may be required to procure on behalf of its retail ratepayers. An Order was issued by the FERC in July 2010, indicating that KU is not required to allocate a portion of any renewable resources to the twelve municipalities, thus resolving the remaining issue.

### 2008 Kentucky Rate Case

In July 2008, KU filed an application with the Kentucky Commission requesting an increase in electric base rates. In January 2009, KU, the AG, the KIUC and all other parties to the rate case filed a settlement agreement with the Kentucky Commission, under which KU's electric base rates decreased by \$9 million annually. An Order approving the settlement agreement was received in February 2009. The new rates were implemented effective February 6, 2009.

## Regulatory Assets and Liabilities

The following regulatory assets and liabilities were included in the Balance Sheets as of December 31:

	Successor 2010	Predecessor 2009
Current regulatory assets:		
ECR (a)	\$ -	\$ 28
FAC (a)	-	1
Coal contracts (b)	4	-
MISO exit (c)	-	2
Other (d)	5	1
Total current regulatory assets	<u>\$ 9</u>	<u>\$ 32</u>
Non-current regulatory assets:		
Pension and postretirement benefits (e)	\$ 117	\$ 105
Other non-current regulatory assets:		
Storm restoration (c)	57	59
ARO (f)	2	30
Unamortized loss on bonds (c)	12	12
Coal contracts (b)	14	-
MISO exit (a)	5	9
Unamortized debt expense	5	-
Other (d)	10	7
Subtotal other non-current regulatory assets	<u>105</u>	<u>117</u>
Total non-current regulatory assets	<u>\$ 222</u>	<u>\$ 222</u>
Current regulatory liabilities:		
Coal contracts	\$ 16	\$ -
ECR	12	-
FAC	2	-
DSM	5	3
Emission allowances	6	-
Other (g)	-	1
Total current regulatory liabilities	<u>\$ 41</u>	<u>\$ 4</u>
Non-current regulatory liabilities:		
Accumulated cost of removal of utility plant	\$ 348	\$ 335
Other non-current regulatory liabilities:		
Coal contracts	126	-
OVEC power purchase contract	38	-
Deferred income taxes – net	6	9
Postretirement benefits	10	9
Other (g)	6	7
Subtotal other non-current regulatory liabilities	<u>186</u>	<u>25</u>
Total non-current regulatory liabilities	<u>\$ 534</u>	<u>\$ 360</u>

- (a) The FAC and ECR regulatory assets have separate recovery mechanisms with recovery within twelve months.
- (b) Offsetting regulatory asset for fair value purchase accounting adjustments. See Note 2, Acquisition by PPL, for information on the purchase accounting adjustments.
- (c) These regulatory assets are recovered through base rates.
- (d) Other regulatory assets include:
  - The CMRG and KCCS contributions, an EKPC FERC transmission settlement agreement and rate case expenses, which are recovered through base rates.
  - The FERC jurisdictional portion of the EKPC FERC transmission settlement agreement included in current and non-current regulatory assets, recovered through the application of the annual OATT formula rate updates.
  - FERC jurisdictional pension expense, which will be requested in a future FERC rate case.
  - Offsetting regulatory asset for fair value purchase accounting adjustment for leases. See Note 2, Acquisition by PPL, for information on the purchase accounting adjustments.
  - The Virginia levelized fuel factor, which is a separate recovery mechanism with recovery within twelve months.
- (e) KU generally recovers this asset through pension expense included in the calculation of base rates.
- (f) When an asset with an ARO is retired, the related ARO regulatory asset will be offset against the associated ARO regulatory liability, ARO asset and ARO liability.
- (g) Other regulatory liabilities includes the emission allowance purchase accounting offset, MISO exit and a change in accounting method for FERC jurisdictional spare parts.

### *ECR*

KU recovers the costs of complying with the Federal Clean Air Act pursuant to Kentucky Revised Statute 278-183 as amended and those federal, state or local environmental requirements which apply to coal combustion wastes and by-products from facilities utilized for production of energy from coal, through the ECR mechanism. The amount of the regulatory asset or liability is the amount that has been under- or over-recovered due to timing or adjustments to the mechanism.

The Kentucky Commission requires reviews of the past operations of the environmental surcharge for six-month and two-year billing periods to evaluate the related charges, credits and rates of return, as well as to provide for the roll-in of ECR amounts to base rates each two-year period. In December 2010, the Kentucky Commission initiated a six-month review of the Utilities' environmental surcharge for the billing period ending October 2010. An order is expected in the second quarter of 2011. Also, in December 2010, an Order was issued approving the charges and credits billed through the ECR during the six-month period ending April 2010, as well as approving billing adjustments for under-recovered costs and the rate of return on capital. In May 2010, an Order was issued approving the amounts billed through the ECR during the six-month period ending October 2009, and the rate of return on capital and allowing recovery of the under-recovery position in subsequent monthly filings. In December 2009, an Order was issued approving the charges and credits billed through the ECR during the two-year period ending April 2009, an increase in the jurisdictional revenue requirement, a base rate roll-in and a revised rate of return on capital. In July 2009, an Order was issued approving the charges and credits billed through the ECR during the six-month period ending October 2008, as well as approving billing adjustments for under-recovered costs and the rate of return on capital. In August 2008, an Order was issued approving the charges and credits billed through the ECR during the six-month periods ending April

2008 and October 2007, and the rate of return on capital. In March 2008, an Order was issued approving the charges and credits billed through the ECR during the six-month and two-year periods ending October 2006 and April 2007, respectively, as well as approving billing adjustments, roll-in adjustments to base rates, revisions to the monthly surcharge filing and the rates of return on capital.

In June 2009, the Company filed an application for a new ECR plan with the Kentucky Commission seeking approval to recover investments in environmental upgrades and operations and maintenance costs at the Company's generating facilities. During 2009, KU reached a unanimous settlement with all parties to the case and the Kentucky Commission issued an Order approving KU's application. Recovery on customer bills through the monthly ECR surcharge for these projects began with the February 2010 billing cycle. At December 31, 2009, the Company had a regulatory asset of \$28 million, which changed to a regulatory liability in the first quarter of 2010, as a result of these roll-in adjustments to base rates. At December 31, 2010, the regulatory liability balance was \$12 million.

In February 2009, the Kentucky Commission approved a settlement agreement in the rate case which provides for an authorized return on equity applicable to the ECR mechanism of 10.63% effective with the February 2009 expense month filing, which represents a slight increase over the previously authorized 10.50%. The 10.63% return on equity for the ECR mechanism was affirmed in the 2010 rate case.

#### *FAC*

KU's retail rates contain an FAC, whereby increases and decreases in the cost of fuel for generation are reflected in the rates charged to retail customers. The FAC allows the Company to adjust billed amounts for the difference between the fuel cost component of base rates and the actual fuel cost, including transportation costs. Refunds to customers occur if the actual costs are below the embedded cost component. Additional charges to customers occur if the actual costs exceed the embedded cost component. The amount of the regulatory asset or liability is the amount that has been under- or over-recovered due to timing or adjustments to the mechanism.

The Kentucky Commission requires public hearings at six-month intervals to examine past fuel adjustments and at two-year intervals to review past operations of the fuel clause and transfer of the then current fuel adjustment charge or credit to the base charges. In December 2010, May 2010, November 2009, January 2009, June 2008 and January 2008, the Kentucky Commission issued Orders approving the charges and credits billed through the FAC for the six-month periods ending April 2010, August 2009, April 2009, April 2008, October 2007 and April 2007, respectively. In January 2009 the Kentucky Commission initiated routine examinations of the FAC for the two-year periods November 1, 2006 through October 31, 2008. The Kentucky Commission issued an Order in June 2009 approving the charges and credits billed through the FAC during the review periods.

KU also employs an FAC mechanism for Virginia customers using an average fuel cost factor based primarily on projected fuel costs. The Virginia levelized fuel factor allows fuel recovery based on projected fuel costs for the coming year plus an adjustment for any over- or under-recovery of fuel expenses from the prior year. At December 31, 2010 and 2009, KU had a regulatory asset of \$5 million and less than \$1 million, respectively.

In February 2010, KU filed an application with the Virginia Commission seeking approval of a decrease in its fuel cost factor beginning with service rendered in April 2010. An Order was issued in April 2010, resulting in an agreed upon decrease of 23% from the fuel factor in effect for April 2009 through March 2010.

In February 2009, KU filed an application with the Virginia Commission seeking approval of a 29% increase in its fuel cost factor beginning with service rendered in April 2009. In February 2009, the Virginia Commission issued an Order allowing the requested change to become effective on an interim basis. The Virginia Staff testimony filed in April 2009 recommended a slight decrease in the factor filed by KU. The Company indicated the Virginia Staff proposal was acceptable. A hearing was held in May 2009, with general resolution of remaining issues. In May 2009, the Virginia Commission issued an Order approving the revised fuel factor, representing an increase of 24%, effective May 2009.

In February 2008, KU filed an application with the Virginia Commission seeking approval of a decrease in its fuel cost factor applicable during the billing period, April 2008 through March 2009. The Virginia Commission allowed the new rates to be in effect for the April 2008 customer billings. In April 2008, the Virginia Commission Staff recommended a change to the fuel factor KU filed in its application, to which KU agreed. Following a public hearing and an Order in May 2008, the recommended change became effective in June 2008, resulting in a decrease of 0.482 cents/kWh from the factor in effect for the April 2007 through March 2008 period.

#### *Coal Contracts*

In November 2010, purchase accounting adjustments were recorded for the fair value of KU's coal contracts. Offsetting regulatory asset or liability for fair value purchase accounting adjustments eliminate any ratemaking impact of the fair value adjustments.

#### *MISO*

Following receipt of applicable FERC, Kentucky Commission and other regulatory Orders, related to proceedings that had been underway since July 2003, KU withdrew from the MISO effective September 1, 2006. Since the exit from the MISO, KU has been operating under a FERC approved OATT. KU now contracts with the TVA to act as its transmission reliability coordinator and SPP to function as its independent transmission operator, pursuant to FERC requirements. The contractual obligations with the TVA extend through August 2011 and with SPP through August 2012.

KU and the MISO agreed upon overall calculation methods for the contractual exit fee to be paid by the Company following its withdrawal. In October 2006, the Company paid \$20 million to the MISO and made related FERC compliance filings. The Company's payment of this exit fee was with reservation of its rights to contest the amount, or components thereof, following a continuing review of its calculation and supporting documentation. KU and the MISO resolved their dispute regarding the calculation of the exit fee and, in November 2007, filed an application with the FERC for approval of a recalculation agreement. In March 2008, the FERC approved the parties' recalculation of the exit fee and the approved agreement providing KU with recovery of \$4 million, of which \$1 million was immediately recovered in 2008, with the remainder to be recovered over the seven years from 2008 through 2014 for credits realized from other payments the MISO will receive, plus interest.

In accordance with Kentucky Commission Orders approving the MISO exit, KU established a regulatory asset for the MISO exit fee, net of former MISO administrative charges collected via base rates through the base rate case test year ended April 30, 2008. The net MISO exit fee is subject to adjustment for possible future MISO credits and a regulatory liability for certain revenues associated with former MISO administrative charges, which were collected via base rates until February 6, 2009. The approved 2008 base rate case settlement provided for MISO administrative charges collected through base rates from May 1, 2008 to February 6, 2009, and any future adjustments to the MISO exit fee, to be established as a regulatory liability until the amounts can be amortized in future base rate cases. This regulatory liability balance as of October 31, 2009, was included in the base rate case application filed on January 29, 2010. MISO exit fee credit amounts subsequent to October 31, 2009, will continue to accumulate as a regulatory liability until they can be amortized in future base rate cases.

In November 2008, the FERC issued Orders in industry-wide proceedings relating to MISO RSG calculation and resettlement procedures. RSG charges are amounts assessed to various participants active in the MISO trading market which generally seek to compensate for uneconomic generation dispatch due to regional transmission or power market operational considerations, with some customer classes eligible for payments, while others may bear charges. The FERC Orders approved two requests for significantly altered formulas and principles, each of which the FERC applied differently to calculate RSG charges for various historical and future periods. Based upon the 2008 FERC Orders, the Company established a reserve during the fourth quarter of 2008 of less than \$1 million relating to potential RSG resettlement costs for the period ended December 31, 2008. However, in May 2009, after a portion of the resettlement payments had been made, the FERC issued an Order on the requests for rehearing on one November 2008 Order which changed the effective date and reduced almost all of the previously accrued RSG resettlement costs. Therefore, these costs were reversed and a receivable was established for amounts already paid of less than \$1 million. The MISO began refunding the amounts to the Company in June 2009 with full repayment by September 2009. In June 2009, the FERC issued an Order in the rate mismatch RSG proceeding, stating it will not require resettlements of the rate mismatch calculation from April 1, 2005 to November 4, 2007. An accrual had previously been recorded in 2008 for the rate mismatch issue for the time period April 25, 2006 to August 9, 2007, but no accrual had been recorded for the time period November 5, 2007 to November 9, 2008 based on the prior Order. Accordingly, the accrual for the former time period was reversed and an accrual for the latter time period was recorded in June 2009, with a net effect of \$1 million of expense, substantially all of which was paid by September 2009.

In August 2009, the FERC determined that the MISO had failed to demonstrate that its proposed exemptions to real-time RSG charges were just and reasonable. In November 2009, the MISO made a compliance filing incorporating the rulings of the FERC Orders and a related task force, with a primary open issue being whether certain of the tariff changes are applied prospectively only or retroactively to approximately January 6, 2009.

In November 2009, the Utilities filed an application with the FERC to approve certain independent transmission operator arrangements to be effective upon the expiration of their current contract with SPP in September 2010. The application sought authority for KU and LG&E to function after such date as the administrators of their own OATT for most purposes. However, due to the lack of FERC approval for such an approach and the approaching expiration of the SPP contract, the Utilities determined the approach was no longer reasonably achievable without unacceptable delay and uncertainty. In July 2010, the Utilities entered into a new agreement with SPP to provide independent transmission operator



services for a specified, limited time and removed its application for authority of administering its own OATT. The TVA, which currently acts as reliability coordinator, has also been retained under the existing service contract. The new agreement extends TVA services to August 2011 with no alterations or changes to the party's duties or responsibilities.

In August 2010, the FERC issued three Orders accepting most facets of several MISO RSG compliance filings. The FERC ordered the MISO to issue refunds for RSG charges that were imposed by the MISO on the assumption that there were rate mismatches for the period beginning November 5, 2007 through the present. There is no financial statement impact to the Company from this Order, as the MISO had anticipated that the FERC would require these refunds and had preemptively included them in the resettlements paid in 2009. The FERC denied the MISO's proposal to exempt certain resources from RSG charges, effective prospectively. The FERC accepted portions and rejected portions of the MISO's proposed RSG rate Redesign Proposal, which will be effective when the software is ready for implementation subject to further compliance filings. The impact of the Redesign Proposal on the Company cannot be estimated at this time.

#### *Pension and Postretirement Benefits*

KU accounts for pension and postretirement benefits in accordance with the compensation – retirement benefits guidance of the FASB ASC. This guidance requires employers to recognize the over-funded or under-funded status of a defined benefit pension and postretirement plan as an asset or liability on the Balance Sheets and to recognize through other comprehensive income the changes in the funded status in the year in which the changes occur. Under the regulated operations guidance of the FASB ASC, KU can defer recoverable costs that would otherwise be charged to expense or equity by non-regulated entities. Current rate recovery in Kentucky and Virginia is based on the compensation – retirement benefits guidance of the FASB ASC. Regulators have been clear and consistent with their historical treatment of such rate recovery; therefore, the Company has recorded a regulatory asset representing the change in funded status of its pension plan that is expected to be recovered and a regulatory liability representing the change in funded status of its postretirement benefit plan. The regulatory asset and liability will be adjusted annually as prior service cost and actuarial gains and losses are recognized in net periodic benefit cost.

#### *Storm Restoration*

In January 2009, a significant ice storm passed through KU's service area causing approximately 199,000 customer outages, followed closely by a severe wind storm in February 2009, causing approximately 44,000 customer outages. An application was filed with the Kentucky Commission in April 2009, requesting approval to establish a regulatory asset and defer for future recovery approximately \$62 million in incremental operation and maintenance expenses related to the storm restoration. In September 2009, the Kentucky Commission issued an Order allowing the establishment of a regulatory asset of up to \$62 million based on actual costs for storm damages and service restoration due to the January and February 2009 storms. In September 2009, a regulatory asset of \$57 million was established for actual costs incurred and approval was received in KU's 2010 base rate case to recover this asset over a ten year period beginning August 1, 2010.

In September 2008, high winds from the remnants of Hurricane Ike passed through the service area causing significant outages and system damage. In October 2008, an application was filed with the

Kentucky Commission requesting approval to establish regulatory assets and defer for future recovery approximately \$3 million of expenses related to the storm restoration. In December 2008, the Kentucky Commission issued an Order allowing the establishment a regulatory asset of up to \$3 million based on actual costs for storm damages and service restoration due to Hurricane Ike. In December 2008, a regulatory asset of \$2 million was established for actual costs incurred and KU received approval in its 2010 base rate case to recover this asset over a ten year period, beginning August 1, 2010.

#### *Unamortized Loss on Bonds*

The costs of early extinguishment of debt, including call premiums, legal and other expenses, and any unamortized balance of debt expense are amortized using the straight-line method, which approximates the effective interest method, over the life of either the replacement debt (in the case of refinancing) or the original life of the extinguished debt.

#### *CMRG and KCCS Contributions*

In July 2008, KU and LG&E, along with Duke Energy Kentucky, Inc. and Kentucky Power Company, filed an application with the Kentucky Commission requesting approval to establish regulatory assets related to contributions to the CMRG for the development of technologies for reducing carbon dioxide emissions and the KCCS to study the feasibility of geologic storage of carbon dioxide. The filing companies proposed that these contributions be treated as regulatory assets to be deferred until recovery is provided in the next base rate case of each company, at which time the regulatory assets will be amortized over the life of each project: four years with respect to the KCCS and ten years with respect to the CMRG. KU and LG&E jointly agreed to provide \$2 million over two years to the KCCS and up to \$2 million over ten years to the CMRG. In October 2008, an Order approving the establishment of the requested regulatory assets was received. KU received approval from the Kentucky Commission in the Company's 2010 Kentucky base rate case to recover these regulatory assets over the requested period beginning August 1, 2010.

#### *Rate Case Expenses*

KU incurred \$1 million in expenses related to the development and support of the 2008 Kentucky base rate case. The Kentucky Commission approved the establishment of a regulatory asset for these expenses and authorized amortization over three years beginning in March 2009.

KU incurred \$2 million in expenses related to the development and support of the 2010 Kentucky base rate case. The Kentucky Commission approved the establishment of a regulatory asset for these expenses and authorized amortization over three years beginning in August 2010.

#### *FERC Jurisdictional Pension Costs*

Other regulatory assets include pension costs of \$5 million incurred by the Company and allocated to its FERC jurisdictional ratepayers. The Company will seek recovery of this asset in the next FERC rate proceeding.

### *Deferred Storm Costs*

Based on an Order from the Kentucky Commission in June 2004, KU reclassified from maintenance expense to a regulatory asset \$4 million related to costs not reimbursed from the 2003 ice storm. These costs were amortized through June 2009. KU earned a return of these amortized costs, which were included in jurisdictional operating expenses.

### *DSM*

DSM consists of energy efficiency programs which are intended to reduce peak demand and delay the investment in additional power plant construction, provide customers with tools and information to become better managers of their energy usage and prepare for potential future legislation governing energy efficiency. KU's rates contain a DSM provision which includes a rate mechanism that provides for concurrent recovery of DSM costs and provides an incentive for implementing DSM programs. The provision allows KU to recover revenues from lost sales associated with the DSM programs based on program plan engineering estimates and post-implementation evaluations.

In July 2007, KU and LG&E filed an application with the Kentucky Commission requesting an order approving enhanced versions of the existing DSM programs along with the addition of several new cost effective programs. The total annual budget for these programs is approximately \$26 million. In March 2008, the Kentucky Commission issued an Order approving the application, with minor modifications. KU and LG&E filed revised tariffs in April 2008, under authority of this Order, which were effective in May 2008.

### *Emission Allowances*

In November 2010, purchase accounting adjustments were recorded for the fair market value of KU's SO<sub>2</sub>, NO<sub>x</sub> ozone season and NO<sub>x</sub> annual emission allowances. Offsetting regulatory assets or liabilities for fair value purchase accounting adjustments eliminate any ratemaking impact of the fair value adjustments. KU is granted SO<sub>2</sub> emission allowances through 2040 and NO<sub>x</sub> ozone season and NO<sub>x</sub> annual emission allowances through 2011.

### *Accumulated Cost of Removal of Utility Plant*

As of December 31, 2010 and 2009, KU segregated the cost of removal, previously embedded in accumulated depreciation, of \$348 million and \$335 million, respectively, in accordance with FERC Order No. 631. For reporting purposes on the Balance Sheets, KU presented this cost of removal as a "Regulatory liability" pursuant to the regulated operations guidance of the FASB ASC.

### *OVEC Power Purchase Contract*

In November 2010, purchase accounting adjustments were recorded for the fair value of the power purchase agreement between KU and OVEC. Offsetting regulatory liability for fair value purchase accounting adjustment eliminate any ratemaking impact of the fair value adjustments.

### *Deferred Income Taxes – Net*

These regulatory liabilities represent the future revenue impact from the reversal of deferred income taxes required for unamortized investment tax credits, the allowance for funds used during construction and deferred taxes provided at rates in excess of currently enacted rates.

### Other Regulatory Matters

#### *Kentucky Commission Report on Storms*

In November 2009, the Kentucky Commission issued a report following review and analysis of the effects and utility response to the September 2008 wind storm and the January 2009 ice storm and possible utility industry preventative measures relating thereto. The report suggested a number of proposed or recommended preventative or responsive measures, including consideration of selective hardening of facilities, altered vegetation management programs, enhanced customer outage communications and similar measures. In March 2010, the Utilities filed a joint response reporting on their actions with respect to such recommendations. The response indicated implementation or completion of substantially all of the recommendations, including, among other matters, on-going reviews of system hardening and vegetation management procedures, certain test or pilot programs in such areas and fielding of enhanced operational and customer outage-related systems.

#### *Wind Power Agreements*

In August 2009, KU and LG&E filed a notice of intent with the Kentucky Commission indicating their intent to file an application for approval of wind power purchase contracts and cost recovery mechanisms. The contracts were executed in August 2009 and were contingent upon KU and LG&E receiving acceptable regulatory approvals. Pursuant to the proposed 20-year contracts, KU and LG&E would jointly purchase respective assigned portions of the output of two Illinois wind farms totaling an aggregate 109.5 Mw. In September 2009, the Utilities filed an application and supporting testimony with the Kentucky Commission. In October 2009, the Kentucky Commission issued an Order denying the Utilities' request to establish a surcharge for recovery of the costs of purchasing wind power. The Kentucky Commission stated that such recovery constitutes a general rate adjustment and is subject to the regulations of a base rate case. The Kentucky Commission Order provided for the request for approval of the wind power agreements to proceed independently from the request to recover the costs thereof via surcharges. In November 2009, KU and LG&E filed for rehearing of the Kentucky Commission's Order and requested that the matters of approval of the contract and recovery of the costs thereof remain the subject of the same proceeding. During December 2009, the Kentucky Commission issued data requests on this matter. In March 2010, the Utilities delivered notices of termination under provisions of the wind power contracts. The Utilities also filed a motion with the Kentucky Commission noting the termination of the contracts and seeking withdrawal of their application in the related regulatory proceeding. In April 2010, the Kentucky Commission issued an Order allowing the Utilities to withdraw their pending application.

#### *Trimble County Asset Purchase and Depreciation*

In July 2009, the Utilities notified the Kentucky Commission of the proposed sale from the Utilities of certain ownership interests in certain existing Trimble County generating station assets which were

anticipated to provide joint or common use in support of the jointly-owned TC2 generating unit under construction at the station. The undivided ownership interests sold provide KU an ownership interest in these common assets proportional to its interest in TC2 and the assets' role in supporting both TC1 and TC2. In December 2009, the Utilities completed the sale transaction at a price of \$48 million, representing the current net book value of the assets multiplied by the proportional interest being sold.

In August 2009, the Utilities jointly filed an application with the Kentucky Commission to approve new depreciation rates for applicable jointly-owned TC2-related generating, pollution control and other plant equipment and assets. During December 2009, the Kentucky Commission extended the data discovery process through January 2010 and authorized the Utilities on an interim basis to begin using the depreciation rates for TC2 as proposed in the application. In March 2010, the Kentucky Commission issued a final Order approving the use of the proposed depreciation rates on a permanent basis.

#### *TC2 CCN Application and Transmission Matters*

An application for a CCN for construction of TC2 was approved by the Kentucky Commission in November 2005. CCNs for two transmission lines associated with TC2 were issued by the Kentucky Commission in September 2005 and May 2006. All regulatory approvals and rights of way for one transmission line have been obtained.

KU's and LG&E's CCN for a transmission line associated with the TC2 construction has been challenged by certain property owners in Hardin County, Kentucky. Certain proceedings relating to CCN challenging and federal historic preservation permit requirements have concluded with outcomes in the Utilities' favor.

Completion of the transmission lines are also subject to standard construction permit, environmental authorization and real property or easement acquisition procedures. Certain Hardin County landowners have raised challenges to the transmission line in some of these forums as well.

With respect to the remaining on-going dispute, KU obtained various successful rulings during 2008 at the Hardin County Circuit Court confirming its condemnation rights. In August 2008, several landowners appealed such rulings to the Kentucky Court of Appeals and received a temporary stay preventing KU from accessing their properties. In May 2010, the Kentucky Court of Appeals issued an Order affirming the Hardin Circuit Court's finding that KU had the right to condemn easements on the properties. In May 2010, the landowners filed a petition for reconsideration with the Court of Appeals. In July 2010, the Court of Appeals denied that petition. In August, 2010, the landowners filed for discretionary review of that denial by the Kentucky Supreme Court.

Settlement discussions with the Hardin County property owners involved in the appeals of the condemnation proceedings have been unsuccessful to date. During the fourth quarter of 2008, KU and LG&E entered into settlements with certain Meade County landowners and obtained dismissals of prior litigation they brought challenging the same transmission line.

As a result of the aforementioned unresolved litigation delays encountered in obtaining access to certain properties in Hardin County, KU obtained easements to allow construction of temporary transmission facilities, bypassing those properties while the litigated issues are resolved. In September 2009, the Kentucky Commission issued an Order stating that a CCN was necessary for two segments of the

proposed temporary facilities. In December 2009, the Kentucky Commission granted the CCNs for the relevant segments and the property owners have filed various motions to intervene, stay and appeal certain elements of the Kentucky Commission's recent orders. In January 2010, in respect of two of such proceedings, the Franklin County circuit court issued Orders denying the property owners' request for a stay of construction and upholding the prior Kentucky Commission denial of their intervenor status.

Consistent with the regulatory authorizations and the favorable outcome of the legal proceedings, the Utilities completed construction activities on the permanent transmission line easements. During 2010, the Utilities placed the transmission line into operation. While the Utilities are not currently able to predict the ultimate outcome and possible financial effects of the remaining legal proceedings, the Utilities do not believe the matter involves relevant or continuing risks to operations.

#### *Utility Competition in Virginia*

The Commonwealth of Virginia passed the Virginia Electric Utility Restructuring Act in 1999. This act gave customers the ability to choose their electric supplier and capped electric rates through December 2010. KU subsequently received a legislative exemption from the customer choice requirements of this law. In April 2007, however, the Virginia General Assembly amended the Virginia Electric Utility Restructuring Act, thereby terminating this competitive market and commencing re-regulation of utility rates. The new act ended the cap on rates at the end of 2008. Pursuant to this legislation, the Virginia Commission adopted regulations revising the rules governing utility rate increase applications. As of January 2009, a hybrid model of regulation is being applied in Virginia. Under this model, utility rates are reviewed every two years. KU's exemption from the requirements of the Virginia Electric Utility Restructuring Act in 1999, however, discharges the Company from the requirements of the new hybrid model of regulation. In lieu of submitting an annual information filing, the Company has the option of requesting a change in base rates to recover prudently incurred costs by filing a traditional base rate case. KU is also subject to other utility regulations in Virginia, including, but not limited to, the recovery of prudently incurred fuel costs through an annual fuel factor charge and the submission of integrated resource plans.

#### *Market-Based Rate Authority*

In July 2006, the FERC issued an Order in KU's market-based rate proceeding accepting the Company's further proposal to address certain market power issues the FERC claimed would arise upon an exit from the MISO. In particular, the Company received permission to sell power at market-based rates at the interface of balancing areas in which it may be deemed to have market power, subject to a restriction that such power will not be collusively re-sold back into such balancing areas. However, restrictions exist on sales by KU of power at market-based rates in the KU and LG&E and Big Rivers Electric Company balancing areas. In June 2007, the FERC issued Order No. 697 implementing certain reforms to market-based rate regulations, including restrictions similar to those previously in place for the Company's power sales at balancing area interfaces. In December 2008, the FERC issued Order No. 697-B potentially placing additional restrictions on certain power sales involving areas where market power is deemed to exist. As a condition of receiving and retaining market-based rate authority, KU must comply with applicable affiliate restrictions set forth in the FERC regulation. During September 2008, the Company submitted a regular triennial update filing under market-based rate regulations.

In June 2009, the FERC issued Order No. 697-C which generally clarified certain interpretations relating to power sales and purchases at balancing area interfaces or into balancing areas involving market power. In July 2009, the FERC issued an Order approving the Company's September 2008 application for market-based rate authority. During July 2009, affiliates of KU completed a transaction terminating certain prior generation and power marketing activities in the Big Rivers Electric Company balancing area, which termination should ultimately allow a filing to request a determination that the Company no longer is deemed to have market power in such balancing area.

KU conducts certain of its wholesale power sales activities in accordance with existing market-based rate authority principles and interpretations. Future FERC proceedings relating to Orders 697 or market-based rate authority could alter the amount of sales made at market-based versus cost-based rates. The Company's sales under market-based rate authority totaled less than \$1 million for the year ended December 31, 2010.

#### *Mandatory Reliability Standards*

As a result of the EPCRA 2005, certain formerly voluntary reliability standards became mandatory in June 2007 and authority was delegated to various Regional Reliability Organizations ("RROs") by the NERC, which was authorized by the FERC to enforce compliance with such standards, including promulgating new standards. Failure to comply with mandatory reliability standards can subject a registered entity to sanctions, including potential fines of up to \$1 million per day, as well as non-monetary penalties, depending upon the circumstances of the violation. The Utilities are members of the SERC, which acts as KU's and LG&E's RRO. During December 2009 and April, July and August 2010, the Utilities submitted ten self-reports relating to various standards, which self-reports remain in the early stages of RRO review, and therefore, the Utilities are unable to estimate the outcome of these matters. Mandatory reliability standard settlements commonly also include non-penalty elements, including compliance steps and mitigation plans. Settlements with SERC proceed to NERC and FERC review before becoming final. While the Utilities believe they are in compliance with the mandatory reliability standards, events of potential non-compliance may be identified from time-to-time. The Utilities cannot predict such potential violations or the outcome of self-reports described above.

#### *Integrated Resource Planning*

Integrated resource planning ("IRP") regulations in Kentucky require major utilities to make triennial IRP filings with the Kentucky Commission. In April 2008, KU and LG&E filed their 2008 joint IRP with the Kentucky Commission. The IRP provides historical and projected demand, resource and financial data and other operating performance and system information. The Kentucky Commission issued a staff report and Order closing this proceeding in December 2009. Pursuant to the Virginia Commission's December 2008 Order, KU filed its IRP in July 2009. The filing consisted of the 2008 Joint IRP filed by KU and LG&E with the Kentucky Commission along with additional data. The Virginia Commission has not established a procedural schedule for this proceeding. KU expects to file their next IRP in April 2011.

#### *PUHCA 2005*

PPL, KU's ultimate parent, is a holding company under PUHCA 2005. PPL, its utility subsidiaries, including KU, and certain of its non-utility subsidiaries, are subject to extensive regulation by the FERC

with respect to numerous matters, including electric utility facilities and operations, wholesale sales of power and related transactions, accounting practices, issuances and sales of securities, acquisitions and sales of utility properties, payments of dividends out of capital and surplus, financial matters and inter-system sales of non-power goods and services. KU believes that it has adequate authority, including financing authority, under existing FERC Orders and regulations to conduct its business and will seek additional authorization when necessary.

### *EPAct 2005*

The EPAct 2005 was enacted in August 2005. Among other matters, this comprehensive legislation contains provisions mandating improved electric reliability standards and performance; granting enhanced civil penalty authority to the FERC; providing economic and other incentives relating to transmission, pollution control and renewable generation assets; increasing funding for clean coal generation incentives; repealing the Public Utility Holding Company Act of 1935; enacting PUHCA 2005; and expanding FERC jurisdiction over public utility holding companies and related matters via the Federal Power Act and PUHCA 2005.

In February 2006, the Kentucky Commission initiated an administrative proceeding to consider the requirements of the EPAct 2005, Subtitle E Section 1252, Smart Metering, which concerns time-based metering and demand response, and Section 1254, Interconnections. EPAct 2005 requires each state regulatory authority to conduct a formal investigation and issue a decision on whether or not it is appropriate to implement certain Section 1252 standards within eighteen months after the enactment of EPAct 2005 and to commence consideration of Section 1254 standards within one year after the enactment of EPAct 2005. Following a public hearing with all Kentucky jurisdictional electric utilities, in December 2006, the Kentucky Commission issued an Order in this proceeding indicating that the EPAct 2005 Section 1252 and Section 1254 standards should not be adopted. However, all five Kentucky Commission jurisdictional utilities were required to file real-time pricing pilot programs for their large commercial and industrial customers. KU developed a real-time pricing pilot program for large industrial and commercial customers and filed the details of the plan with the Kentucky Commission in April 2007. In February 2008, the Kentucky Commission issued an Order approving the real-time pricing pilot program proposed by KU for implementation within approximately eight months. The tariff was filed in October 2008, with an effective date of December 1, 2008. KU files annual reports on the program within 90 days of each plan year end for the three-year pilot period.

### *Green Energy Riders*

In February 2007, KU and LG&E filed a Joint Application and Testimony for Proposed Green Energy Riders. In May 2007, a Kentucky Commission Order was issued authorizing KU to establish Small and Large Green Energy Riders, allowing customers to contribute funds to be used for the purchase of renewable energy credits. During November 2009, KU and LG&E filed an application to both continue and modify the existing Green Energy Programs. In February 2010, the Kentucky Commission approved the Utilities' application, as filed.

### *Home Energy Assistance Program*

In July 2007, KU filed an application with the Kentucky Commission for the establishment of a Home Energy Assistance program. During September 2007, the Kentucky Commission approved the five-year



program as filed, effective in October 2007. The programs were scheduled to terminate in September 2012 and is funded through a \$0.10 per month meter charge. Effective February 6, 2009, as a result of the settlement agreement in the 2008 base rate case, the program is funded through a \$0.15 per month meter charge. As a condition in the settlement in the change of control proceeding before the Kentucky Commission in the PPL acquisition, the program was extended to September 2015.

#### *Collection Cycle Revision*

As part of its base rate case filed on July 29, 2008, LG&E proposed to change the due date for customer bill payments from 15 days to 10 days to align its collection cycle with KU. In addition, in its rate case filed on July 29, 2008, KU proposed to include a late payment charge if payment is not received within 15 days from the bill issuance date to align with LG&E. The settlement agreements approved in the rate cases in February 2009 changed the due date for customer bill payments to 12 days after bill issuance for both KU and LG&E and permitted KU's implementation of a late payment charge if payment is not received within 15 days from the bill issuance date.

#### *Depreciation Study*

In December 2007, KU filed a depreciation study with the Kentucky Commission as required by a previous Order. In August 2008, the Kentucky Commission issued an Order consolidating the depreciation study with the base rate case proceeding. The approved settlement agreements in the rate cases established new depreciation rates effective February 2009. KU also filed the depreciation study with the Virginia Commission which approved the implementation of the new depreciation rates effective February 2009. Approval by the Virginia Commission does not preclude the rates from being raised as an issue by any party in KU's future base rate cases in Virginia.

#### *Brownfield Development Rider Tariff*

In March 2008, KU received Kentucky Commission approval for a Brownfield Development Rider, which offers a discounted rate to electric customers who meet certain usage and location requirements, including taking new service at a Brownfield site, as certified by the appropriate Kentucky state agency. The rider permits special contracts with such customers which provide for a series of declining partial rate discounts over an initial five-year period of a longer service arrangement. The tariff is intended to promote local economic redevelopment and efficient usage of utility resources by aiding potential reuse of vacant Brownfield sites.

#### *Interconnection and Net Metering Guidelines*

In May 2008, the Kentucky Commission on its own motion initiated a proceeding to establish interconnection and net metering guidelines in accordance with amendments to existing statutory requirements for net metering of electricity. The jurisdictional electric utilities and intervenors in this case presented proposed interconnection guidelines to the Kentucky Commission in October 2008. In a January 2009 Order, the Kentucky Commission issued the Interconnection and Net Metering Guidelines – Kentucky that were developed by all parties to the proceeding. KU does not expect any financial or other impact as a result of this Order. In April 2009, KU filed revised net metering tariffs and application forms pursuant to the Kentucky Commission's Order. The Kentucky Commission issued an Order in April 2009, which suspended for five months all net metering tariffs filed by the jurisdictional

electric utilities. This suspension was intended to allow sufficient time for review of the filed tariffs by the Kentucky Commission Staff and intervening parties. In June 2009, the Kentucky Commission Staff held an informal conference with the parties to discuss issues related to the net metering tariffs filed by KU. Following this conference, the intervenors and KU resolved all issues and KU filed revised net metering tariffs with the Kentucky Commission. In August 2009, the Kentucky Commission issued an Order approving the revised tariffs.

*EISA 2007 Standards*

In November 2008, the Kentucky Commission initiated an administrative proceeding to consider new standards as a result of the Energy Independence and Security Act of 2007 (“EISA 2007”), part of which amends the Public Utility Regulatory Policies Act of 1978 (“PURPA”). There are four new PURPA standards and one non-PURPA standard applicable to electric utilities. The proceeding also considers two new PURPA standards applicable to natural gas utilities. EISA 2007 requires state regulatory commissions and non-regulated utilities to begin consideration of the rate design and smart grid investments no later than December 19, 2008 and to complete the consideration by December 19, 2009. The Kentucky Commission established a procedural schedule that allowed for data discovery and testimony through July 2009. In October 2009, the Kentucky Commission held an informal conference for the purpose of discussing issues related to the standard regarding the consideration of Smart Grid investments. A public hearing has not been scheduled in this matter.

**Note 4 - Asset Retirement Obligations**

A summary of KU’s net ARO assets, ARO liabilities and regulatory assets established under the asset retirement and environmental obligations guidance of the FASB ASC follows:

	ARO Net <u>Assets</u>	ARO <u>Liabilities</u>	Regulatory <u>Assets</u>
As of December 31, 2008, Predecessor	\$ 5	\$ (32)	\$ 28
ARO accretion and depreciation	<u>(1)</u>	<u>(2)</u>	<u>2</u>
As of December 31, 2009, Predecessor	4	(34)	30
ARO accretion and depreciation	-	(2)	2
Reclassification for retired assets	(1)	-	1
ARO revaluation - change in estimates	<u>22</u>	<u>(24)</u>	<u>2</u>
As of October 31, 2010, Predecessor	25	(60)	35
ARO accretion and depreciation	(1)	-	1
Purchase accounting - fair value adjustment	<u>28</u>	<u>6</u>	<u>(34)</u>
As of December 31, 2010, Successor	<u>\$ 52</u>	<u>\$ (54)</u>	<u>\$ 2</u>

In September 2010, the Company performed a revaluation of its AROs as a result of recently proposed environmental legislation and improved ability to forecast asset retirement costs due to recent construction and retirement activity.

In November 2010, the Company recorded a purchase accounting adjustment to fair value AROs due to the PPL acquisition.

Pursuant to regulatory treatment prescribed under the regulated operations guidance of the FASB ASC, an offsetting regulatory credit was recorded in “Depreciation and amortization” in the Statements of Income for the Successor of \$1 million in 2010 and \$2 million for the Predecessor for the ARO accretion and depreciation expense. The offsetting regulatory credit recorded was \$2 million in 2009 and 2008 for the ARO accretion and depreciation expense. The ARO liabilities are offset by cash settlements that have not yet been applied. Therefore, ARO net assets, ARO liabilities and regulatory assets balances do not net to zero due to the cash settlements.

KU’s AROs are primarily related to the final retirement of assets associated with generating units. KU transmission and distribution lines largely operate under perpetual property easement agreements which do not generally require restoration upon removal of the property. Therefore, under the asset retirement and environmental obligations guidance of the FASB ASC, no material asset retirement obligations are recorded for transmission and distribution assets.

#### **Note 5 – Derivative Financial Instruments**

KU is subject to interest rate and commodity price risk related to on-going business operations. The Company’s policies allow for the interest rate risk to be managed through the use of fixed rate debt, floating rate debt and interest rate swaps. Although the Company’s policies allow for the use of interest rate swaps, as of December 31, 2010 and 2009, KU had no interest rate swaps outstanding. At December 31, 2010, KU’s potential annual exposure to increased interest expense, based on a 10% increase in interest rates, was less than \$1 million.

The Company does not net collateral against derivative instruments.

#### Energy Trading and Risk Management Activities

KU conducts energy trading and risk management activities to maximize the value of power sales from physical assets it owns. Energy trading activities are principally forward financial transactions to manage price risk and are accounted for as non-hedging derivatives on a mark-to-market basis in accordance with the derivatives and hedging guidance of the FASB ASC.

Energy trading and risk management contracts are valued using prices based on active trades from Intercontinental Exchange Inc. In the absence of a traded price, midpoints of the best bids and offers are the primary determinants of valuation. When sufficient trading activity data is unavailable, other inputs include prices quoted by brokers or observable inputs other than quoted prices, such as one-sided bids or offers as of the balance sheet date. Quotes are verified quarterly using an independent pricing source of actual transactions. Quotes for combined off-peak and weekend timeframes are allocated between the two timeframes based on their historical proportional ratios to the integrated cost. No other adjustments are made to the forward prices. No changes to valuation techniques for energy trading and risk management activities occurred during 2010 or 2009. Changes in market pricing, interest rate and volatility assumptions were made during both years.

KU's financial assets and liabilities as of December 31, 2010 and December 31, 2009, arising from energy trading and risk management contracts not designated as hedging instruments accounted for at fair value total less than \$1 million and are recorded in prepayments and other current assets and other current liabilities, respectively.

The Company maintains credit policies intended to minimize credit risk in wholesale marketing and trading activities by assessing the creditworthiness of potential counterparties prior to entering into transactions with them and continuing to evaluate their creditworthiness once transactions have been initiated. To further mitigate credit risk, KU seeks to enter into netting agreements or require cash deposits, letters of credit and parental company guarantees as security from counterparties. The Company uses ratings of S&P, Moody's and definitive qualitative and quantitative data to assess the financial strength of counterparties on an on-going basis. If no external rating exists, KU assigns an internally generated rating for which it sets appropriate risk parameters. As risk management contracts are valued based on changes in market prices of the related commodities, credit exposures are revalued and monitored on a daily basis. At December 31, 2010, 100% of the trading and risk management commitments were with counterparties rated BBB-/Baa3 equivalent or better. The Company has reserved against counterparty credit risk based on KU's own creditworthiness (for net liabilities) and its counterparty's creditworthiness (for net assets). The Company applies historical default rates within varying credit ratings over time provided by S&P or Moody's. At December 31, 2010 and December 31, 2009, counterparty credit reserves related to energy trading and risk management contracts were less than \$1 million.

The net volume of electricity based financial derivatives outstanding at December 31, 2010 and December 31, 2009, was 129,199 Mwh and 315,600 Mwh, respectively. Cash collateral related to the energy trading and risk management contracts was less than \$1 million at December 31, 2010 and December 31, 2009. Cash collateral related to the energy trading and risk management contracts is recorded in "Prepayments and other current assets" on the Balance Sheets.

KU manages the price risk of its estimated future excess economic generation capacity using market-traded forward contracts. Hedge accounting treatment has not been elected for these transactions; therefore, realized and unrealized gains and losses are included in the Statements of Income.

The following table presents the effect of market-traded forward contract derivatives not designated as hedging instruments on income:

Loss Recognized in Income	Location	Successor	Predecessor	
		November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31, 2009    2008
Unrealized gain (loss)	Electric revenues	\$ -	\$ -	\$ (1)    \$ 1

Net realized gains and losses were zero for the period ended December 31, 2010 and less than \$1 million for the periods ended October 31, 2010, December 31, 2009 and December 31, 2008.

### Credit Risk Related Contingent Features

Certain of KU's derivative contracts contain credit contingent provisions which would permit the counterparties with which KU is in a net liability position to require the transfer of additional collateral upon a decrease in KU's credit rating. Some of these provisions would require KU to transfer additional collateral or permit the counterparty to terminate the contract if KU's credit rating were to fall below investment grade. Some of these provisions also allow the counterparty to require additional collateral upon each decrease in the credit rating at levels that remain above investment grade. In either case, if KU's credit rating were to fall below investment grade (i.e., below BBB- for S&P or Baa3 for Moody's), and assuming no assignment to an investment grade affiliate were allowed, most of these credit contingent provisions require either immediate payment of the net liability as a termination payment or immediate and ongoing full collateralization by KU on derivative instruments in net liability positions.

Additionally, certain of KU's derivative contracts contain credit contingent provisions that require KU to provide "adequate assurance" of performance if the other party has reasonable grounds for insecurity regarding KU's performance of its obligation under the contract. A counterparty demanding adequate assurance could require a transfer of additional collateral or other security, including letters of credit, cash and guarantees from a creditworthy entity. A demand for additional assurance would typically involve negotiations among the parties.

To determine net liability positions, KU uses the fair value of each agreement. At December 31, 2010, there were no energy trading and risk management derivative contracts with credit risk related contingent features that are in a liability position and collateral of less than \$1 million was posted in the normal course of business. At December 31, 2010, a downgrade of the Company's credit rating below investment grade would have no effect on the energy trading and risk management derivative contracts or collateral required.

### **Note 6 - Fair Value Measurements**

KU adopted the fair value guidance in the FASB ASC in two phases. Effective January 1, 2008, the Company adopted it for all financial instruments and non-financial instruments accounted for at fair value on a recurring basis, and effective January 1, 2009, the Company adopted it for all non-financial instruments accounted for at fair value on a non-recurring basis. The FASB ASC guidance clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, the FASB ASC guidance establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value.

The carrying values and estimated fair values of KU's non-trading financial instruments follow:

	Successor		Predecessor	
	December 31, 2010		December 31, 2009	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Long-term bonds	\$ 1,841	\$ 1,728	\$ 351	\$ 351
Long-term debt to affiliated company	-	-	1,331	1,401

The long-term fixed rate pollution control bond valuations reflect prices quoted by investment banks, which are active in the market for these instruments. First mortgage bond valuations reflect prices quoted from a third party service. The fair value of the long-term debt due to affiliated company is determined using an internal valuation model that discounts the future cash flows of each loan at current market rates as determined based on quotes from investment banks that are actively involved in capital markets for utilities and factor in KU's credit ratings and default risk. The fair values of cash and cash equivalents, accounts receivable, cash surrender value of key man life insurance, accounts payable and notes payable are substantially the same as their carrying values.

KU has classified the applicable financial assets and liabilities that are accounted for at fair value into the three levels of the fair value hierarchy, as defined by the fair value measurements and disclosures guidance of the FASB ASC, as discussed in Note 1, Summary of Significant Accounting Policies.

The Company classifies its derivative cash collateral balances within level 1 based on the funds being held in a demand deposit account. The Company classifies its derivative energy trading and risk management contracts within level 2 because it values them using prices actively quoted for proposed or executed transactions, quoted by brokers or observable inputs other than quoted prices.

KU's financial assets and liabilities as of December 31, 2010 and 2009, arising from energy trading and risk management contracts accounted for at fair value on a recurring basis total less than \$1 million. Cash collateral related to the energy trading and risk management contracts was less than \$1 million at December 31, 2010 and December 31, 2009 each year.

There were no level 3 measurements for the periods ending December 31, 2010 and December 31, 2009.

#### **Note 7 - Goodwill and Intangible Assets**

In connection with PPL's acquisition of LKE, KU recorded goodwill on November 1, 2010. In addition, as of November 1, 2010, certain intangible assets were adjusted to their fair value and new intangible assets were recorded. See Note 2, Acquisition by PPL, for further information.

##### Goodwill

The Company performs its required annual goodwill impairment test in the fourth quarter. Impairment tests are performed between the annual tests when the Company determines that a triggering event has occurred that would, more likely than not, reduce the fair value of a reporting unit below its carrying value. The goodwill impairment test is comprised of a two-step process. In step 1, the Company identifies a potential impairment by comparing the estimated fair value of the regulated utilities (the

goodwill reporting unit) to their carrying value, including goodwill, on the measurement date. If the estimated fair value exceeds its carrying amount, goodwill is not considered impaired. If the fair value is less than the carrying value, then step 2 is performed to measure the amount of impairment loss, if any. The step 2 calculation compares the implied fair value of the goodwill to the carrying value of the goodwill. The implied fair value of goodwill is equal to the excess of the Company estimated fair value over the fair values of its identified assets and liabilities. If the carrying value of goodwill exceeds the implied fair value of goodwill, an impairment loss is recognized in an amount equal to that excess (but not in excess of the carrying value).

In connection with PPL's acquisition of LKE on November 1, 2010, goodwill of \$607 million was recorded on November 1, 2010. The allocation of the goodwill to KU was based on the net asset value of the Company. The goodwill represents value paid for the rate regulated business located in a defined service area with a constructive regulatory environment, which provides for future investment, earnings and cash flow growth, as well as the talented and experienced workforce. KU's franchise values are being attributed to the going concern value of the business and thus were recorded as goodwill rather than a separately identifiable intangible asset. None of the goodwill recognized is expected to be deductible for income tax purposes or included in customer rates. See Note 2, Acquisition by PPL, for further information.

For the 2010 annual impairment test, the primary valuation technique used was an income methodology based on management's estimates of forecasted cash flows for the Company, with those cash flows discounted to present value using rates commensurate with the risks of those cash flows. Management also took into consideration the acquisition price paid by PPL. The discounted cash flows for the Company was based on discrete financial forecasts developed by management for planning purposes and consistent with those given to PPL. Cash flows beyond the discrete forecasts were estimated using a terminal-value calculation, which incorporated historical and forecasted financial trends for the Company. No impairment resulted from the fourth quarter test, as the determined fair value of the Company was greater than its carrying value.

#### Other Intangible Assets

The gross carrying amount and the accumulated amortization of other intangible assets were as follows:

	<u>Successor</u>	
	<u>December 31, 2010</u>	
	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>
Subject to amortization:		
Coal contracts (a)	\$ 145	\$ 3
Land rights (b)	8	-
Emission allowances (c)	9	-
OVEC power purchase agreement (d)	39	1
Total other intangible assets	<u>\$ 201</u>	<u>\$ 4</u>

- (a) The gross carrying amount represents the fair value of coal contracts recognized as a result of the 2010 acquisition by PPL. The weighted average amortization period of these contracts is 3 years. See Note 2, Acquisition by PPL, for further information.

- (b) The gross carrying amount represents the fair value of land rights recognized as a result of adopting PPL's accounting policies in the Successor period. The weighted average amortization period of these rights is 17 years. See Note 1, Summary of Significant Accounting Policies, for further information.
- (c) The gross carrying amount represents the fair value of emission allowances recognized as a result of the 2010 acquisition by PPL, as well as the reclassification of amounts from inventory to intangible assets as a result of adopting PPL's accounting policies in the Successor period. The weighted average amortization period of these emission allowances is 3 years. See Note 2, Acquisition by PPL, for further information.
- (d) The gross carrying amount represents the fair value of the OVEC power purchase contract recognized as a result of the 2010 acquisition by PPL. The weighted average amortization period of the power purchase agreement is 8 years. See Note 2, Acquisition by PPL, for further information.

Current intangible assets and long-term intangible assets are included in "Other intangible assets" in their respective areas on the Balance Sheets in 2010. Intangible assets resulting from purchase accounting adjustments are not recoverable in rates.

Amortization expense, excluding consumption of emission allowances, was \$4 million for the Successor in 2010. The estimated aggregate amortization expense for each of the next five years is as follows:

	Estimated Expense in Period Ended				
	2011	2012	2013	2014	2015
Aggregate amortization expense	\$ 43	\$ 25	\$ 27	\$ 24	\$ 26

#### **Note 8 - Concentrations of Credit and Other Risk**

Credit risk represents the accounting loss that would be recognized at the reporting date if counterparties failed to perform as contracted. Concentrations of credit risk (whether on- or off-balance sheet) relate to groups of customers or counterparties that have similar economic or industry characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions.

All of KU's customer receivables arise from deliveries of electricity. During 2010, the Company's ten largest customers accounted for less than 19% of volumes.

Effective August 4, 2009, KU and its employees represented by the IBEW Local 2100 entered into a three-year collective bargaining agreement. The agreement provides for negotiated increases or changes to wages, benefits or other provisions and for annual wage re-openers. KU and its employees represented by the USWA Local 9447-01 entered into a three-year collective bargaining agreement in August 2008. This agreement provides for negotiated increases or changes to wages, benefits or other provisions and for annual wage re-openers. The employees represented by these two bargaining units comprise approximately 15% of the Company's workforce at December 31, 2010.



## Note 9 - Pension and Other Postretirement Benefit Plans

KU employees benefit from both funded and unfunded retirement benefit plans. Its defined benefit pension plan covers employees hired by December 31, 2005. Employees hired after this date participate in the Retirement Income Account (“RIA”), a defined contribution plan. The postretirement plan includes health care benefits that are contributory, with participants’ contributions adjusted annually. The Company uses December 31 as the measurement date for its plans.

### Obligations and Funded Status

The following tables provide a reconciliation of the changes in the defined benefit plans’ obligations, the fair value of assets and the funded status of the plans for November 1, 2010 through December 31, 2010, for the Successor, and for January 1, 2010 through October 31, 2010, and January 1, 2009 through December 31, 2009, for the Predecessor:

	Pension Benefits			Other Postretirement Benefits		
	Successor	Predecessor		Successor	Predecessor	
	2010	2010	2009	2010	2010	2009
Change in benefit obligation:						
Benefit obligation at beginning of period	\$ 355	\$ 316	\$ 306	\$ 84	\$ 80	\$ 75
Service cost	1	5	6	-	1	2
Interest cost	3	16	18	1	4	4
Benefits paid, net of retiree contributions	(3)	(14)	(18)	(1)	(4)	(5)
Actuarial (gain) loss and other	(2)	32	4	(1)	3	4
Benefit obligation at end of period	<u>\$ 354</u>	<u>\$ 355</u>	<u>\$ 316</u>	<u>\$ 83</u>	<u>\$ 84</u>	<u>\$ 80</u>

	Pension Benefits			Other Postretirement Benefits		
	Successor	Predecessor		Successor	Predecessor	
	2010	2010	2009	2010	2010	2009
Change in plan assets:						
Fair value of plan assets at beginning of period	\$ 237	\$ 219	\$ 183	\$ 20	\$ 17	\$ 12
Actual return on plan assets	7	20	41	-	1	3
Employer contributions	-	13	13	2	6	7
Benefits paid, net of retiree contributions	(3)	(14)	(18)	(1)	(4)	(5)
Administrative expenses and other	-	(1)	-	-	-	-
Fair value of plan assets at end of period	<u>\$ 241</u>	<u>\$ 237</u>	<u>\$ 219</u>	<u>\$ 21</u>	<u>\$ 20</u>	<u>\$ 17</u>
Funded status at end of period	<u>\$ (113)</u>	<u>\$ (118)</u>	<u>\$ (97)</u>	<u>\$ (62)</u>	<u>\$ (64)</u>	<u>\$ (63)</u>

Amounts Recognized in the Balance Sheets

The following tables provide the amounts recognized in the Balance Sheets and information for plans with benefit obligations in excess of plan assets plans for November 1, 2010 through December 31, 2010, for the Successor, and for January 1, 2010 through October 31, 2010, and January 1, 2009 through December 31, 2009, for the Predecessor:

	Pension Benefits			Other Postretirement Benefits		
	Successor	Predecessor		Successor	Predecessor	
	2010	2010	2009	2010	2010	2009
Regulatory assets	\$ 117	\$ 125	\$ 105	\$ -	\$ -	\$ -
Regulatory liabilities	-	-	-	(10)	(9)	(9)
Accrued benefit liability (non-current)	(113)	(118)	(97)	(62)	(64)	(63)

Amounts recognized in regulatory assets and liabilities for November 1, 2010 through December 31, 2010, for the Successor, and for January 1, 2010 through October 31, 2010, and January 1, 2009 through December 31, 2009, for the Predecessor:

	Pension Benefits			Other Postretirement Benefits		
	Successor	Predecessor		Successor	Predecessor	
	2010	2010	2009	2010	2010	2009
Transition obligation	\$ -	\$ -	\$ -	\$ 2	\$ 2	\$ 3
Prior service cost	3	4	5	1	1	2
Accumulated loss (gain)	114	121	100	(13)	(12)	(14)
Total regulatory assets and liabilities	\$ 117	\$ 125	\$ 105	\$ (10)	\$ (9)	\$ (9)

Additional information for plans with accumulated benefit obligations in excess of plan assets for November 1, 2010 through December 31, 2010, for the Successor, and for January 1, 2010 through October 31, 2010, and January 1, 2009 through December 31, 2009, for the Predecessor:

	Pension Benefits			Other Postretirement Benefits		
	Successor	Predecessor		Successor	Predecessor	
	2010	2010	2009	2010	2010	2009
Benefit obligation	\$ 354	\$ 355	\$ 316	\$ 83	\$ 84	\$ 80
Accumulated benefit obligation	299	299	268	-	-	-
Fair value of plan assets	241	237	219	21	20	17

The amounts recognized in regulatory assets and liabilities for November 1, 2010 through December 31, 2010, for the Successor, and for January 1, 2010 through October 31, 2010, and January 1, 2009 through December 31, 2009, for the Predecessor:

	Pension Benefits			Other Postretirement Benefits		
	Successor	Predecessor		Successor	Predecessor	
	2010	2010	2009	2010	2010	2009
Net (gain) loss arising during the period	\$ (6)	\$ 26	\$ (22)	\$ (1)	\$ 2	\$ 2
Amortization of prior service cost	-	(1)	(1)	-	-	-
Amortization of transitional obligation	-	-	-	-	(2)	(1)
Amortization of loss	(2)	(5)	(9)	-	-	-
Total amounts recognized in regulatory assets and liabilities	<u>\$ (8)</u>	<u>\$ 20</u>	<u>\$ (32)</u>	<u>\$ (1)</u>	<u>\$ -</u>	<u>\$ 1</u>

For discussion of the pension and postretirement regulatory assets, see Note 3, Rates and Regulatory Matters.

#### Components of Net Periodic Benefit Cost

The following tables provide the components of net periodic benefit cost for pension and other postretirement benefit plans. The tables include the costs associated with both KU employees and Servco employees who provide services to KU. The Servco costs are allocated to KU based on employees' labor charges and are approximately 51%, 49% and 46% of Servco's costs for 2010, 2009 and 2008, respectively.

	Pension Benefits					
	Successor			Predecessor		
	November 1, 2010 through December 31, 2010			January 1, 2010 through October 31, 2010		
	KU	Servco Allocation to KU		KU	Servco Allocation to KU	
Total KU		Total KU	Total KU		Total KU	
Service cost	\$ 1	\$ 1	\$ 2	\$ 5	\$ 5	\$ 10
Interest cost	3	2	5	16	6	22
Expected return on plan assets	(3)	(1)	(4)	(14)	(5)	(19)
Amortization of prior service cost	-	-	-	1	1	2
Amortization of actuarial gain	2	-	2	5	2	7
Net periodic benefit cost	<u>\$ 3</u>	<u>\$ 2</u>	<u>\$ 5</u>	<u>\$ 13</u>	<u>\$ 9</u>	<u>\$ 22</u>

Pension Benefits

	Predecessor - Year Ended December 31, 2009			Predecessor - Year Ended December 31, 2008		
	KU	Servco Allocation to KU	Total KU	KU	Servco Allocation to KU	Total KU
Service cost	\$ 6	\$ 5	\$ 11	\$ 6	\$ 4	\$ 10
Interest cost	18	7	25	18	6	24
Expected return on plan assets	(15)	(4)	(19)	(21)	(5)	(26)
Amortization of prior service cost	1	1	2	1	1	2
Amortization of actuarial gain	9	2	11	-	-	-
Net periodic benefit cost	<u>\$ 19</u>	<u>\$ 11</u>	<u>\$ 30</u>	<u>\$ 4</u>	<u>\$ 6</u>	<u>\$ 10</u>

Other Postretirement Benefits

	Successor November 1, 2010 through December 31, 2010			Predecessor January 1, 2010 through October 31, 2010		
	KU	Servco Allocation to KU	Total KU	KU	Servco Allocation to KU	Total KU
Service cost	\$ -	\$ -	\$ -	\$ 1	\$ 1	\$ 2
Interest cost	1	-	1	4	-	4
Expected return on plan assets	-	-	-	(1)	-	(1)
Amortization of transition obligation	-	-	-	1	-	1
Net periodic benefit cost	<u>\$ 1</u>	<u>\$ -</u>	<u>\$ 1</u>	<u>\$ 5</u>	<u>\$ 1</u>	<u>\$ 6</u>

Other Postretirement Benefits						
	Predecessor - Year Ended December 31, 2009			Predecessor Year Ended December 31, 2008		
	KU	Servco Allocation to KU	Total KU	KU	Servco Allocation to KU	Total KU
Service cost	\$ 1	\$ 1	\$ 2	\$ 1	\$ 1	\$ 2
Interest cost	5	-	5	5	-	5
Expected return on plan assets	(1)	-	(1)	(1)	-	(1)
Amortization of transition obligation	1	-	1	1	-	1
Net periodic benefit cost	<u>\$ 6</u>	<u>\$ 1</u>	<u>\$ 7</u>	<u>\$ 6</u>	<u>\$ 1</u>	<u>\$ 7</u>

The estimated amounts that will be amortized from regulatory assets and liabilities into net periodic benefit cost in 2011 are shown in the following table:

	Pension Benefits	Other Postretirement Benefits
Regulatory assets and liabilities:		
Net actuarial loss	\$ 8	\$ -
Prior service cost	1	1
Transition obligation	-	1
Total regulatory assets and liabilities amortized during 2011	<u>\$ 9</u>	<u>\$ 2</u>

The weighted average assumptions used in the measurement of KU's pension and postretirement benefit obligations for November 1, 2010 through December 31, 2010, for the Successor, and for January 1, 2010 through October 31, 2010, and January 1, 2009 through December 31, 2009, for the Predecessor are shown in the following table:

	Successor	Predecessor	
	December 31, 2010	October 31, 2010	December 31, 2009
Discount rate – pension benefits	5.52%	5.46%	6.13%
Discount rate – postretirement benefits	5.12%	4.96%	5.82%
Rate of compensation increase	5.25%	5.25%	5.25%

For the first ten months of 2010, the discount rates used to determine the pension and postretirement benefit obligations and the period expense were determined using the Mercer Pension Discount Yield Curve. This model takes the plans' cash flows and matches them to a yield curve that provides the equivalent yields on zero-coupon corporate bonds for each maturity. The discount rate is the single rate

that produces the same present value of cash flows. The selection of the various discount rates represents the equivalent single rate under a broad-market AA yield curve constructed by Mercer.

For the last two months of 2010, the Towers Watson Yield Curve was used to determine the discount rate. This model also starts with an analysis of the expected benefit payment stream for its plans. This information is first matched against a spot-rate yield curve. A portfolio of Aa-graded non-callable (or callable with make-whole provisions) bonds, with a total amount outstanding in excess of \$667 billion, serves as the base from which those with the lowest and highest yields are eliminated to develop the ultimate yield curve. The results of this analysis are considered together with other economic data and movements in various bond indices to determine the discount rate assumption.

The weighted average assumptions used in the measurement of KU's pension and postretirement net periodic benefit costs for November 1, 2010 through December 31, 2010, for the Successor, and for January 1, 2010 through October 31, 2010, and January 1, 2009 through December 31, 2009, for the Predecessor are shown in the following table:

	Successor	Predecessor		
	2010	2010	2009	2008
Discount rate - pension	5.45%	5.46%	6.25%	6.66%
Discount rate - postretirement	4.94%	5.82%	6.36%	6.56%
Expected long-term return on plan assets	7.25%	7.75%	8.25%	8.25%
Rate of compensation increase	5.25%	5.25%	5.25%	5.25%

To develop the expected long-term rate of return on assets assumption, KU considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset class was then weighted based on the current asset allocation to develop the expected long-term rate of return on assets assumption for the portfolio. The Company has determined that the 2011 expected long-term rate of return on assets assumption should be 7.25%.

The following describes the effects on pension benefits by changing the major actuarial assumptions discussed above:

- A 1% change in the assumed discount rate would have a \$39 million positive or negative impact to the 2010 accumulated benefit obligation and an approximate \$51 million positive or negative impact to the 2010 projected benefit obligation.
- A 25 basis point change in the expected rate of return on assets would have resulted in less than a \$1 million positive or negative impact to 2010 pension expense.
- A 25 basis point increase in the rate of compensation increase would have a \$3 million negative impact to the 2010 projected benefit obligation.

#### Assumed Health Care Cost Trend Rates

For measurement purposes, an 8% annual increase in the per capita cost of covered health care benefits was assumed for the first ten months of 2010. The rate was assumed to decrease gradually to 4.5% by 2029 and remain at that level thereafter. For the last two months of 2010, an 8% annual increase in the

per capita cost of covered health care benefits was assumed and the rate was assumed to decrease gradually to 5.5% by 2019. For 2011, a 9% annual increase in the per capita cost of covered health care benefits is assumed and the rate is assumed to decrease gradually to 5.5% by 2019. This change in the length of the health care trend was made to conform to PPL's accounting policies.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 1% change in assumed health care cost trend rates would have resulted in an increase or decrease of less than \$1 million to the 2010 total of service and interest costs components and an increase or decrease of \$4 million in year end 2010 postretirement benefit obligations.

*Expected Future Benefit Payments and Medicare Subsidy Receipts*

The following list provides the amount of expected future benefit payments, which reflect expected future service costs and the estimated gross amount of Medicare subsidy receipts:

	Pension Benefits	Other Postretirement Benefits	Medicare Subsidy Receipts
2011	\$ 18	\$ 6	\$ 1
2012	18	6	-
2013	18	6	1
2014	18	7	-
2015	18	7	1
2016-2020	106	36	3

Plan Assets

The following table shows the pension plan's weighted average asset allocation by asset category at December 31:

	Target Range	Successor 2010	Predecessor 2009
Equity securities	45% - 75%	56%	59%
Debt securities	30% - 50%	24%	40%
Other	0% - 10%	20%	1%
Totals		100%	100%

The investment policy of the pension plans was developed in conjunction with financial and actuarial consultants, investment advisors and legal counsel. The goal of the investment policy is to preserve the capital of the pension plans' assets and maximize investment earnings in excess of inflation with acceptable levels of volatility. The return objective is to exceed the benchmark return for the policy index comprised of the following: Russell 3000 Index, MSCI-EAFE Index, Barclays Capital Aggregate and Barclays Capital U.S. Long Government/Credit Bond Index in proportions equal to the targeted asset allocation.

Evaluation of performance focuses on a long-term investment time horizon over rolling three and five-year periods. The assets of the pension plans are broadly diversified within different asset classes (equities, fixed income securities and cash equivalents).

To minimize the risk of large losses in a single asset class, no more than 5% of the portfolio will be invested in the securities of any one issuer with the exclusion of the U.S. government and its agencies. The equity portion of the fund is diversified among the market's various subsections to diversify risk, maximize returns and avoid undue exposure to any single economic sector, industry group or individual security. The equity subsectors include, but are not limited to, growth, value, small capitalization and international.

In addition, the overall fixed income portfolio may have an average weighted duration, or interest rate sensitivity which is within +/- 20% of the duration of the overall fixed income benchmark. Foreign bonds in the aggregate shall not exceed 10% of the total fund. The portfolio may include a limited investment of up to 20% in below investment grade securities provided that the overall average portfolio quality remains "AA" or better. The below investment grade securities include, but are not limited to, medium-term notes, corporate debt, non-dollar and emerging market debt and asset backed securities. The cash investments should be in securities that are either short maturities (not to exceed 180 days) or readily marketable with modest risk.

Derivative securities are permitted only to improve the portfolio's risk/return profile, to modify the portfolio's duration or to reduce transaction costs and must be used in conjunction with underlying physical assets in the portfolio. Derivative securities that involve speculation, leverage, interest rate anticipation, or any undue risk whatsoever are not deemed appropriate investments.

The investment objective for the postretirement benefit plan is to provide current income consistent with stability of principal and liquidity while maintaining a stable net asset value of \$1.00 per share. The postretirement funds are invested in a prime cash money market fund that invests primarily in a portfolio of short-term, high-quality fixed income securities issued by banks, corporations and the U.S. government.

KU has classified plan assets that are accounted for at fair value into the three levels of the fair value hierarchy, as defined by the fair value measurements and disclosures guidance of the FASB ASC. See Note 6, Fair Value Measurements, for further information.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

A description of the valuation methodologies used to measure plan assets at fair value is provided below:

*Money market funds:* These investments are public investment vehicles valued using \$1 for the net asset value. The money market funds are classified within level 2 of the valuation hierarchy.

*Common/collective trusts:* Valued based on the beginning of year value of the plan's interests in the trust plus actual contributions and allocated investment income (loss) less actual distributions and allocated administrative expenses. Quoted market prices are used to value investments in the trust, with the exception of the GAC. The fair value of certain other investments for which quoted market prices are not available are valued based on yields currently available on



comparable securities of issuers with similar credit ratings. The common/collective trusts are classified within level 2 of the valuation hierarchy.

The preceding methods described may produce a fair value that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Prior to the acquisition, the GAC was considered an immediate participation guarantee contract which was not included in the fair value table. In accordance with the plan accounting guidance of the FASB ASC, the cost incurred to purchase the GAC prior to March 20, 1992, was permitted to be carried at contract value, since it is a contract with an insurance company and prior to the acquisition it was excluded from the table above. The cost incurred to fund the GAC after March 20, 1992, was carried at contract value in accordance with the plan accounting guidance of the FASB ASC, since it was a contract that incorporates mortality and morbidity risk. Contract value represents cost plus interest income less distributions for benefits and administrative expenses. To conform to PPL's accounting methods, the John Hancock GAC was classified in the fair value table as a level 3 and as "other" rather than "debt securities" in the asset allocation table for the period ended December 31, 2010.

The following table sets forth, by level within the fair value hierarchy, the plan's assets at fair value at December 31:

	Successor		Predecessor	
	Level 2	Level 3	Level 2	Level 3
Money market funds	\$ 2	\$ -	\$ 2	\$ -
Common/collective trusts	213	-	186	-
John Hancock - GAC	-	47	-	-
Total investments at fair value	<u>\$ 215</u>	<u>\$ 47</u>	<u>\$ 188</u>	<u>\$ -</u>

The following table sets forth a reconciliation of changes in the fair value of the plan's level 3 assets for the following period:

	Successor
Balance at November 1, 2010	\$ -
Purchases	1
Transfers into level 3	46
Balance at December 31, 2010	<u>\$ 47</u>

There are no assets categorized as level 1 as of December 31, 2010 and December 31, 2009.

### Contributions

KU made discretionary contributions to the pension plan of \$13 million in 2010 and 2009. Servco made \$9 million and \$8 million in discretionary contributions to its pension plan in 2010 and 2009, respectively. The amount of future contributions to the pension plan will depend upon the actual return on plan assets and other factors, but the Company funds its pension obligations in a manner consistent

with the Pension Protection Act of 2006. The Company made contributions totaling \$43 million in January 2011. See Note 18, Subsequent Events, for further information.

The Company made contributions to its other postretirement benefit plan of \$8 million in 2010 and \$7 million in 2009. In 2011, the Company anticipates making voluntary contributions to fund Voluntary Employee Beneficiary Association trusts to match the annual postretirement expense and funding the 401(h) plan up to the maximum amount allowed by law.

### Pension Legislation

The Pension Protection Act of 2006 was enacted in August 2006. New rules regarding funding of defined benefit plans are generally effective for plan years beginning in 2008. Among other matters, this comprehensive legislation contains provisions applicable to defined benefit plans which generally (i) mandate full funding of current liabilities within seven years; (ii) increase tax-deduction levels regarding contributions; (iii) revise certain actuarial assumptions, such as mortality tables and discount rates; and (iv) raise federal insurance premiums and other fees for under-funded and distressed plans. The legislation also contains a number of provisions relating to defined-contribution plans and qualified and non-qualified executive pension plans and other matters. The Company's plan met the minimum funding requirements as defined by the Pension Protection Act of 2006 for years ended December 31, 2010 and 2009.

### Thrift Savings Plans

KU has a thrift savings plan under section 401(k) of the Internal Revenue Code. Under the plan, eligible employees may defer and contribute to the plan a portion of current compensation in order to provide future retirement benefits. KU makes contributions to the plan by matching a portion of the employees' contributions. The costs of this matching were \$3 million in 2010, 2009 and 2008.

KU also makes contributions to RIAs within the thrift savings plans for certain employees not covered by the non-contributory defined benefit pension plan. These employees consist of those hired after December 31, 2005. The Company makes these contributions based on years of service and the employees' wage and salary levels, and makes them in addition to the matching contributions discussed above. The amounts contributed by the Company under this arrangement were less than \$1 million in 2010, 2009 and 2008.

### Health Care Reform

In March 2010, Health Care Reform (the Patient Protection and Affordable Care Act of 2010) was signed into law. Many provisions of Health Care Reform do not take effect for an extended period of time and many aspects of the law which are currently unclear or undefined will likely be clarified in future regulations.

During 2010, KU recorded an income tax expense of less than \$1 million to recognize the impact of the elimination of the tax deduction related to the Medicare Retiree Drug Subsidy that becomes effective in 2013.

Specific provisions within Health Care Reform that may impact KU include:

- Beginning in 2011, requirements extend dependent coverage up to age 26, remove the \$2 million lifetime maximum and eliminate cost sharing for certain preventative care procedures.
- Beginning in 2018, a potential excise tax is expected on high-cost plans providing health coverage that exceeds certain thresholds.

The Company has evaluated these provisions of Health Care Reform on its benefit programs in consultation with its actuarial consultants and has determined that the excise tax will not have an impact on its postretirement medical plans. The requirement to extend dependent coverage up to age 26 is not expected to have a significant impact on active or retiree medical costs. The Company will continue to monitor the potential impact of any changes to the existing provisions and implementation guidance related to Health Care Reform on its benefit programs.

#### **Note 10 - Income Taxes**

KU's federal income tax return is included in a United States consolidated income tax return filed by LKE's direct parent. Prior to October 31, 2010 the return was included in the consolidated return of E.ON US Investments Corp. Due to the acquisition by PPL, the return will be included in the consolidated PPL return beginning November 1, 2010, for each tax period. Each subsidiary of the consolidated tax group, including KU, calculates its separate income tax for each period. The resulting separate-return tax cost or benefit is paid to or received from the parent company or its designee. The Company also files income tax returns in various state jurisdictions. While 2007 and later years are open under the federal statute of limitations, Revenue Agent Reports for 2007-2008 have been received from the IRS, effectively closing these years to additional audit adjustments. Tax years beginning with 2007 were examined under an IRS program, Compliance Assurance Process ("CAP"). This program accelerates the IRS's review to begin during the year applicable to the return and ends 90 days after the return is filed. KU had no adjustments for the 2007 federal tax return. For 2008, the IRS allowed additional deductions in connection with the Company's application for a change in repair deductions and disallowed certain bonus depreciation claimed on the original return. The net temporary tax impact for the Company was a \$12 million reduction in tax and was recorded in the second quarter of 2010. The 2009 federal return was filed in the third quarter of 2010 and the IRS issued a Partial Acceptance Letter in connection with CAP. The IRS is continuing to review bonus depreciation, storms and other repairs. No net material adverse impact is expected from these remaining areas. The short tax year beginning January 1, 2010 through October 31, 2010, is also being examined under CAP. No material items have been raised by the IRS at this time. The two month period beginning November 1, 2010 and ending December 31, 2010 is not currently under examination.

Additions and reductions of uncertain tax positions during 2010, 2009 and 2008 were less than \$1 million. Possible amounts of uncertain tax positions for KU that may decrease within the next 12 months total less than \$1 million and are based on the expiration of the audit periods as defined in the statutes. If recognized, the less than \$1 million of unrecognized tax benefits would reduce the effective income tax rate.

The amount KU recognized as interest expense and interest accrued related to unrecognized tax benefits was less than \$1 million for the twelve month periods ended and as of December 31, 2010, 2009 and 2008. The interest expense and interest accrued is based on IRS and Kentucky Department of Revenue

large corporate interest rates for underpayment of taxes. At the date of adoption, the Company accrued less than \$1 million in interest expense on uncertain tax positions. KU records the interest as “Interest expense” and penalties, if any, as “Operating expenses” on the Statements of Income and “Other current liabilities” on the Balance Sheets, on a pre-tax basis. No penalties were accrued by the Company through December 31, 2010.

Components of income tax expense are shown in the table below:

	Successor	Predecessor		
	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31, 2009      2008	
Current:				
Federal	\$ 13	\$ 46	\$ (5)	\$ 46
State	3	9	1	10
Deferred:				
Federal – net	4	20	43	(10)
State – net	-	3	7	(3)
Investment tax credit – deferred	-	-	21	25
Total income tax expense	<u>\$ 20</u>	<u>\$ 78</u>	<u>\$ 67</u>	<u>\$ 68</u>

In June 2006, KU and LG&E filed a joint application with the U.S. Department of Energy (“DOE”) requesting certification to be eligible for an investment tax credit applicable to the construction of TC2. In November 2006, the DOE and the IRS announced that KU and LG&E were selected to receive the tax credit. A final IRS certification required to obtain the investment tax credit was received in August 2007. In September 2007, KU received an Order from the Kentucky Commission approving the accounting of the investment tax credit, which includes a full depreciation basis adjustment for the amount of the credit. KU’s portion of the TC2 tax credit is approximately \$101 million. Based on eligible construction expenditures incurred, KU recorded an investment tax credit of \$21 million and \$25 million in 2009 and 2008, respectively, decreasing current federal income taxes. As of December 31, 2009, KU had recorded its maximum credit of \$101 million. The income tax expense impact from amortizing this credit over the life of the related property began when the facility was placed in service in January 2011.

In March 2008, certain environmental and preservation groups filed suit in federal court in North Carolina against the DOE and IRS claiming the investment tax credit program was in violation of certain environmental laws and demanded relief, including suspension or termination of the program. The plaintiffs voluntarily dismissed their complaint in August 2010.

Components of deferred income taxes included in the Balance Sheets are shown below:

	Successor December 31, 2010	Predecessor December 31, 2009
Deferred income tax liabilities:		
Depreciation and other plant-related items	\$ 347	\$ 303
Regulatory assets and other	133	69
Total deferred income tax liabilities	<u>480</u>	<u>372</u>
Deferred income tax assets:		
Regulatory liabilities and other	80	-
Income taxes due to customers	2	4
Pensions and related benefits	9	17
Liabilities and other	19	18
Total deferred income tax assets	<u>110</u>	<u>39</u>
Net deferred income tax liabilities	<u>\$ 370</u>	<u>\$ 333</u>
Balance sheet classification:		
Prepayments and other current assets	\$ (6)	\$ (3)
Deferred income taxes (non-current)	376	336
Net deferred income tax liabilities	<u>\$ 370</u>	<u>\$ 333</u>

The Company expects to have adequate levels of taxable income to realize its recorded deferred income tax assets.

A reconciliation of differences between the income tax expense at the statutory U.S. federal income tax rate and KU's actual income tax expense follows:

	Successor	Predecessor		
	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31,	
			2009	2008
Statutory federal income tax expense	\$ 19	\$ 77	\$ 70	\$ 79
State income taxes – net of federal benefit	2	8	5	5
Qualified production activities deduction	(1)	(4)	(1)	(3)
Dividends received deduction related to EEI investment	-	-	(3)	(8)
Reversal of excess deferred taxes	-	(2)	(2)	(1)
Other differences – net	-	(1)	(2)	(4)
Income tax expense	<u>\$ 20</u>	<u>\$ 78</u>	<u>\$ 67</u>	<u>\$ 68</u>
Effective income tax rate	<u>36.4%</u>	<u>35.8%</u>	<u>33.5%</u>	<u>30.1%</u>

The Tax Relief, Unemployment Reauthorization and Job Creation Act of 2010, enacted December 17, 2010 provided, among other provisions, certain incentives related to bonus depreciation and 100% expensing of qualifying capital expenditures. KU benefited from these new provisions by reducing its 2010 current federal income tax expense. This reduction in federal taxable income for KU does, however, result in a reduction of KU's Section 199 Manufacturing deduction, which is based on manufacturing taxable income and correspondingly increases income tax expense. The impact from these changes on 2010 was not material; however, KU anticipates a significant reduction of taxable income in 2011 and 2012 and a corresponding loss of most, if not all, of the Section 199 Manufacturing deduction for the following two years.

## Note 11 - Long-Term Debt

As summarized below, at December 31, 2010, long-term debt consisted of first mortgage bonds and secured pollution control bonds. At December 31, 2009, long-term debt and the current portion of long-term debt consisted primarily of pollution control bonds and long-term loans from affiliated companies.

	Successor 2010	Predecessor 2009
Current portion of long-term debt to affiliates	\$ -	\$ 33
Long-term debt to affiliated companies	-	1,298
Secured first mortgage bonds, net of debt discount and amortization of debt discount	1,500	-
Pollution control revenue bonds, collateralized by first mortgage bonds	351	351
Fair value adjustment from purchase accounting	1	-
Unamortized discount	(11)	-
Total long-term debt	1,841	1,682
Less current portion	-	261
Long-term debt, excluding current portion	<u>\$ 1,841</u>	<u>\$ 1,421</u>

	Stated Interest Rates	Maturities	Debt Amounts
<u>Successor</u>			
Outstanding at December 31, 2010:			
Current portion	N/A	N/A	\$ -
Non-current portion	Variable – 6.00%	2015-2040	1,841
<u>Predecessor</u>			
Outstanding at December 31, 2009:			
Current portion	Variable – 4.240%	2010-2034	\$ 261
Non-current portion	Variable – 7.035%	2011-2037	1,421

As of December 31, 2009, long-term debt includes \$228 million of pollution control bonds that were classified as current portion because these bonds are subject to tender for purchase at the option of the holder and to mandatory tender for purchase upon the occurrence of certain events. These bonds include Carroll County 2002 Series A and B, 2004 Series A, 2006 Series B and 2008 Series A; Muhlenberg County 2002 Series A; and Mercer County 2000 Series A and 2002 Series A. Maturity dates for these bonds range from 2023 to 2034. As of December 31, 2009, the bonds were classified as current portion of long-term debt because investors could put the bonds back to the Company within one year. As of December 31, 2010, the bonds were reclassified as long-term debt. See Note 1, Summary of Significant Accounting Policies, for changes in classification.

Pollution control bonds are obligations of KU issued in connection with tax-exempt pollution control bonds by various counties in Kentucky. A loan agreement obligates the Company to make debt service payments to the counties in amounts equal to the debt service due from the counties on the related pollution control bonds. Depending on the type of expense, the Successor capitalized debt expenses in long-term other regulatory assets or long-term other assets to align with the term of the debt for which the

expenses were related. The Predecessor capitalized debt expenses in current or long-term other regulatory assets or other current or long-term other assets based on the amount of expense expected to be recovered within the next year through rate recovery. Both Predecessor and Successor amortized debt expenses over the lives of the related bond issues. The Predecessor presentation and the Successor presentation are both appropriate under regulatory practices and GAAP.

In October 2010, in order to secure their respective obligations with respect to the pollution control bonds, KU issued first mortgage bonds to the pollution control bond trustees. KU's first mortgage bonds contain terms and conditions that are substantially parallel to the terms and conditions of the counties' debt, but provide that obligations are deemed satisfied to the extent of payments under the related loan agreement, and thus generally require no separate payment of principal and interest except under certain circumstances, including should KU default on the respective loan agreement. Also in October 2010, one national rating agency revised downward the short-term credit rating of the pollution control bonds and the Company's issuer rating as a result of the pending acquisition by PPL.

Several series of KU's pollution control bonds are insured by monoline bond insurers whose ratings have been reduced due to exposures relating to insurance of sub-prime mortgages. At December 31, 2010, KU had an aggregate \$351 million of outstanding pollution control indebtedness, of which \$96 million is in the form of insured auction rate securities wherein interest rates are reset every 35 days via an auction process. Beginning in late 2007, the interest rates on these insured bonds began to increase due to investor concerns about the creditworthiness of the bond insurers. Since 2008, interest rates increased and the Company experienced "failed auctions" when there were insufficient bids for the bonds. When a failed auction occurs, the interest rate is set pursuant to a formula stipulated in the indenture.

The average annualized interest rates on the auction rate bonds follow:

Successor	Predecessor	
November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	December 31, 2009
0.53%	0.51%	0.44%

The instruments governing this auction rate bond permit KU to convert the bond to other interest rate modes, such as various short-term variable rates, long-term fixed rates or intermediate-term fixed rates that are reset infrequently.

As a result of downgrades of the monoline insurers by all of the rating agencies to levels below that of the Company's rating, the debt ratings of the Company's insured bonds are all based on the Company's senior secured debt rating and are not influenced by the monoline bond insurer ratings.

In connection with the PPL acquisition, on November 1, 2010, KU borrowed \$1,331 million from a PPL subsidiary, in order to repay loans from a subsidiary of E.ON. KU used the net proceeds received from the sale of the first mortgage bonds to repay the debt owed to the PPL subsidiary arising from the borrowing.



In November 2010, KU issued first mortgage bonds totaling \$1,500 million and used the proceeds to repay the loans from a PPL subsidiary mentioned above and for general corporate purposes. The first mortgage bonds were issued at a discount as described in the table below:

<u>First Mortgage Bonds</u>	<u>Principal</u>	<u>Discount Price</u>	<u>First Mortgage Bonds Proceeds (a)</u>
Series due 2015	\$ 250	99.650%	\$ 249
Series due 2020	500	99.622%	498
Series due 2040	750	98.915%	742
Total	<u>\$ 1,500</u>		<u>\$ 1,489</u>

(a) Before expenses other than discount to Purchaser

The first mortgage bonds were issued by KU in accordance with the rules of Section 144A of the Securities Act of 1933. KU has entered into a registration rights agreement in which it has agreed to file a registration statement with the SEC relating to an offer to exchange the first mortgage bonds for publicly tradable securities having substantially identical terms. If ultimate registration and/or certain milestones are not completed by certain dates in mid- and late 2011, the Company has agreed to pay liquidated damages to the bondholders. The liquidated damages would total 0.25% per annum of the principal amount of the bonds for the first 90 days and 0.50% per annum of the principal amount thereafter until the conditions described above have been cured.

There were no redemptions or maturities of long-term debt for 2009. Redemptions and maturities of long-term debt for 2010 are summarized below:

<u>Year</u>	<u>Description</u>	<u>Principal Amount</u>	<u>Rate</u>	<u>Secured/Unsecured</u>	<u>Maturity</u>
<u>Successor</u>					
2010	Due to PPL Investment Corp.	\$ 1,331	4.24%-7.035%	Unsecured	2010-2037
2010	Due to E.ON affiliates	1,331	4.24%-7.035%	Unsecured	2010-2037

Issuances of long-term debt for 2010 and 2009 are summarized below:

<u>Year</u>	<u>Description</u>	<u>Principal Amount</u>	<u>Rate</u>	<u>Secured/Unsecured</u>	<u>Maturity</u>
<u>Successor</u>					
2010	Due to PPL Investment Corp.	\$ 1,331	4.24%-7.035%	Unsecured	2010-2037
2010	First mortgage bonds	250	1.625%	Secured	2015
2010	First mortgage bonds	500	3.25%	Secured	2020
2010	First mortgage bonds	750	5.125%	Secured	2040
<u>Predecessor</u>					
2009	Due to E.ON affiliates	50	4.445%	Unsecured	2019
2009	Due to E.ON affiliates	50	4.81%	Unsecured	2019
2009	Due to E.ON affiliates	50	5.28%	Unsecured	2017

As of December 31, 2010, all of the Company's long-term debt is secured by a first mortgage lien on substantially all of the real and tangible personal property of the Company located in Kentucky.

Long-term debt maturities for KU are shown in the following table:

2011	\$	-
2012		-
2013		-
2014		-
2015		250
Thereafter		<u>1,601</u>
	\$	<u>1,851</u>

KU was in compliance with all debt covenants at December 31, 2010.

See Note 1, Summary of Significant Accounting Policies, for certain debt refinancing and associated transactions completed by KU in connection with the PPL acquisition, Note 2, Acquisition by PPL, for the adjustment made to the pollution control bonds to reflect fair value and Note 15, Related Party Transactions, for long-term debt payable to affiliates.

## Note 12 - Notes Payable and Other Short-Term Obligations

### Intercompany Revolving Line of Credit

KU participates in an intercompany money pool agreement wherein LKE and/or LG&E make funds available to KU at market-based rates (based on highly rated commercial paper issues) of up to \$400 million. Details of the balances are as follows:

	<u>Total Money Pool Available</u>	<u>Amount Outstanding</u>	<u>Balance Available</u>	<u>Average Interest Rate</u>
December 31, 2010, Successor	\$ 400	\$ 10	\$ 390	0.25%
December 31, 2009, Predecessor	400	45	355	0.20%

LKE maintains revolving credit facilities totaling \$300 million at December 31, 2010 and \$313 million at December 31, 2009, to ensure funding availability for the money pool. At December 31, 2010, the LKE facility is with PPL Investment Corp. LKE pays PPL Investment Corp. an annual commitment fee based on the Utilities' current bond ratings on the unused portion of the commitment. At December 31, 2009, one facility, totaling \$150 million, was with E.ON North America, Inc., while the remaining line, totaling \$163 million, was with Fidelia, both affiliated companies of E.ON. The balances are as follows:

	<u>Total Available</u>	<u>Amount Outstanding</u>	<u>Balance Available</u>	<u>Average Interest Rate</u>
December 31, 2010, Successor	\$ 300	\$ -	\$ 300	N/A
December 31, 2009, Predecessor	313	276	37	1.25%

### Bank Revolving Line of Credit

As of December 31, 2010, the Company maintained a \$400 million revolving line of credit with a group of banks maturing in December 2014. The revolving line of credit allows KU to issue letters of credit or borrow funds up to \$400 million. Outstanding letters of credit reduce the facility's available borrowing capacity. The Company pays the banks an annual commitment fee based on current bond ratings on the unused portion of the commitment. At December 31, 2010, there was no amount borrowed under this facility although letters of credit totaling \$198 million have been issued under this facility. This credit agreement contains financial covenants requiring the borrower's debt to total capitalization ratio to not exceed 70%, as calculated pursuant to the credit agreement, and other customary covenants.

As of December 31, 2009, the Company maintained a \$35 million bilateral line of credit with an unaffiliated financial institution maturing in June 2012. The Company paid the banks an annual commitment fee on the unused portion of the commitment. At December 31, 2009, there was no balance outstanding under this facility. This facility was terminated on November 1, 2010, in conjunction with the PPL acquisition.

On December 1, 2010, KU replaced the letters of credit issued under prior letter of credit facilities with letters of credit of the same amount issued under the revolving line of credit. The four letter of credit facilities were subsequently terminated.

KU was in compliance with all line of credit covenants at December 31, 2010.

See Note 1, Summary of Significant Accounting Policies, for certain debt refinancing and associated transactions completed by KU in connection with the PPL acquisition and Note 15, Related Party Transactions, for long-term debt payable to affiliates.

### **Note 13 - Commitments and Contingencies**

#### Operating Leases

KU leases office space, office equipment, plant equipment, real estate, railcars, telecommunications and vehicles and accounts for these leases as operating leases. In addition, KU reimburses LG&E for a portion of the lease expense paid by LG&E for KU's usage of office space leased by LG&E. Total lease expense was \$10 million, \$10 million and \$9 million for 2010, 2009 and 2008, respectively. The future minimum annual lease payments for operating leases for years subsequent to December 31, 2010, are shown in the following table:

2011	\$	8
2012		7
2013		5
2014		5
2015		3
Thereafter		1
	\$	<u>29</u>

### Owensboro Contract Litigation and Termination

In May 2004, the City of Owensboro, Kentucky and OMU commenced a suit against KU concerning a long-term power supply contract (the “OMU Agreement”) with KU. In May 2009, KU and OMU executed a settlement agreement resolving the matter on a basis consistent with prior court rulings and KU has received the agreed settlement amounts. Pursuant to the settlement’s operation, the OMU Agreement terminated in May 2010.

### Sale and Leaseback Transaction

The Company is a participant in a sale and leaseback transaction involving its 62% interest in two jointly owned CTs at KU’s E.W. Brown generating station (Units 6 and 7). Commencing in December 1999, KU and LG&E entered into a tax-efficient, 18-year lease of the CTs. The Utilities have provided funds to fully defease the lease and have executed an irrevocable notice to exercise an early purchase option contained in the lease after 15.5 years. The financial statement treatment of this transaction is no different than if the Utilities had retained its ownership interest. The leasing transaction was entered into following receipt of required state and federal regulatory approvals. At December 31, 2010, the Balance Sheets included these assets at a value of \$65 million, which is reflected in “Regulated utility plant – electric.”

In case of default under the lease, the Company is obligated to pay to the lessor its share of certain fees or amounts. Primary events of default include loss or destruction of the CTs, failure to insure or maintain the CTs and unwinding of the transaction due to governmental actions. No events of default currently exist with respect to the lease. Upon any termination of the lease, whether by default or expiration of its term, title to the CTs reverts jointly to KU and LG&E.

At December 31, 2010, the maximum aggregate amount of default fees or amounts was \$7 million, of which KU would be responsible for 62% (approximately \$4 million). The Company has made arrangements with LKE, via guarantee and regulatory commitment, for LKE to pay its full portion of any default fees or amounts.

### Letters of Credit

KU has provided letters of credit as of December 31, 2010 and 2009, for on-balance sheet obligations totaling \$198 million to support bonds of \$195 million and letters of credit for off-balance sheet obligations totaling less than \$1 million to support certain obligations related to workers’ compensation.

### Commodity Purchases

#### *OVEC*

KU has a contract for power purchases with OVEC, terminating in 2026, for various Mw capacities. KU holds a 2.5% investment interest in OVEC with ten other electric utilities. KU is not the primary beneficiary; therefore, the investment is not consolidated into the Company’s financial statements, but is recorded on the cost basis. OVEC is located in Piketon, Ohio, and owns and operates two coal-fired power plants, Kyger Creek Station in Ohio, and Clifty Creek Station in Indiana. KU is contractually entitled to 2.5% of OVEC’s output, approximately 60 Mw of nameplate generation capacity. Pursuant to

the OVEC power purchase contract, the Company may be conditionally responsible for a 2.5% pro-rata share of certain obligations of OVEC under defined circumstances. These contingent liabilities may include unpaid OVEC indebtedness as well as shortfall amounts in certain excess decommissioning costs and postretirement benefits other than pension. KU's contingent potential proportionate share of OVEC's December 31, 2010 outstanding debt was \$35 million. Future obligations for power purchases from OVEC are demand payments, comprised of annual minimum debt service payments, as well as contractually required reimbursement of plant operating, maintenance and other expenses, and are shown in the following table:

2011	\$	9
2012		10
2013		10
2014		10
2015		10
Thereafter		114
	\$	<u>163</u>

#### *Coal and Natural Gas Transportation Purchase Obligations*

KU has contracts to purchase coal and natural gas transportation. Future obligations are shown in the following table:

2011	\$	439
2012		200
2013		144
2014		93
2015		91
Thereafter		14
	\$	<u>981</u>

#### Construction Program

KU had approximately \$116 million of commitments in connection with its construction program at December 31, 2010.

In June 2006, KU entered into a construction contract regarding the TC2 project. The contract is generally in the form of a turnkey agreement for the design, engineering, procurement, construction, commissioning, testing and delivery of the project, according to designated specifications, terms and conditions. The contract price and its components are subject to a number of potential adjustments which may serve to increase or decrease the ultimate construction price. During 2009 and 2010, KU received several contractual notices from the TC2 construction contractor asserting historical force majeure and excusable event claims for a number of adjustments to the contract price, construction schedule, commercial operations date, liquidated damages or other relevant provisions. In September 2010, KU and the construction contractor agreed to a settlement to resolve the force majeure and excusable event claims occurring through July 2010, under the TC2 construction contract, which settlement provided for a limited, negotiated extension of the contractual commercial operations date and/or relief from liquidated damage calculations. With limited exceptions the Company took care, custody and control of TC2 on January 22, 2011, and has dispatched the unit to meet customer demand

since that date. KU and the contractor agreed to a further amendment of the construction agreement whereby the contractor will complete certain actions relating to identifying and completing any necessary modifications to allow operation of TC2 on all fuels in accordance with initial specifications prior to certain dates, and amending the provisions relating to liquidated damages. KU cannot currently estimate the ultimate outcome of these matters.

### TC2 Air Permit

The Sierra Club and other environmental groups filed a petition challenging the air permit issued for the TC2 baseload generating unit which was issued by the KDAQ in November 2005. In September 2007, the Secretary of the Kentucky Environmental and Public Protection Cabinet issued a final Order upholding the permit. The environmental groups petitioned the EPA to object to the state permit and subsequent permit revisions. In determinations made in September 2008 and June 2009, the EPA rejected most of the environmental groups' claims but identified three permit deficiencies which the KDAQ addressed by revising the permit. In August 2009, the EPA issued an Order denying the remaining claims with the exception of two additional deficiencies which the KDAQ was directed to address. The EPA determined that the proposed permit subsequently issued by the KDAQ satisfied the conditions of the EPA Order although the agency recommended certain enhancements to the administrative record. In January 2010, the KDAQ issued a final permit revision incorporating the proposed changes to address the two EPA objections. In March 2010, the Sierra Club submitted a petition to the EPA to object to the permit revision, which is now pending before the EPA. The Company believes that the final permit as revised should not have a material adverse effect on its financial condition or results of operations. However, until the EPA issues a final ruling on the pending petition and all applicable appeals have been exhausted, the Company cannot predict the final outcome of this matter.

### Environmental Matters

The Company's operations are subject to a number of environmental laws and regulations in each of the jurisdictions in which it operates governing, among other things, air emissions, wastewater discharges, the use, handling and disposal of hazardous substances and wastes, soil and groundwater contamination and employee health and safety. As indicated below and summarized at the conclusion of this section, evolving environmental regulations will likely increase the level of capital and operating and maintenance expenditures incurred by the Company during the next several years. Based upon prior regulatory precedent, the Company believes that many costs of complying with such pending or future requirements would likely be recoverable under the ECR or other potential cost-recovery mechanisms, but the Company can provide no assurance as to the ultimate outcome of such proceedings before the regulatory authorities.

### *Ambient Air Quality*

The Clean Air Act requires the EPA to periodically review the available scientific data for six criteria pollutants and establish concentration levels in the ambient air sufficient to protect the public health and welfare with an extra margin for safety. These concentration levels are known as NAAQS. Each state must identify "nonattainment areas" within its boundaries that fail to comply with the NAAQS and develop a SIP to bring such nonattainment areas into compliance. If a state fails to develop an adequate plan, the EPA must develop and implement a plan. As the EPA increases the stringency of the NAAQS

through its periodic reviews, the attainment status of various areas may change, thereby triggering additional emission reduction obligations under revised SIPs aimed to achieve attainment.

In 1997, the EPA established new NAAQS for ozone and fine particulates that required additional reductions in SO<sub>2</sub> and NO<sub>x</sub> emissions from power plants. In 1998, the EPA issued its final “NO<sub>x</sub> SIP Call” rule requiring reductions in NO<sub>x</sub> emissions of approximately 85% from 1990 levels in order to mitigate ozone transport from the midwestern U.S. to the northeastern U.S. To implement the new federal requirements, Kentucky amended its SIP in 2002 to require electric generating units to reduce their NO<sub>x</sub> emissions to 0.15 pounds weight per MMBtu on a company-wide basis. In 2005, the EPA issued the CAIR which required additional SO<sub>2</sub> emission reductions of 70% and NO<sub>x</sub> emission reductions of 65% from 2003 levels. The CAIR provided for a two-phase cap and trade program, with initial reductions of NO<sub>x</sub> and SO<sub>2</sub> emissions due by 2009 and 2010, respectively, and final reductions due by 2015. In 2006, Kentucky proposed to amend its SIP to adopt state requirements similar to those under the federal CAIR.

In July 2008, a federal appeals court issued a ruling finding deficiencies in the CAIR and vacating it. In December 2008, the Court amended its previous Order, directing the EPA to promulgate a new regulation but leaving the CAIR in place in the interim. The remand of the CAIR results in some uncertainty with respect to certain other EPA or state programs and proceedings and the Utilities’ compliance plans relating thereto due to the interconnection of the CAIR with such associated programs.

In January 2010, the EPA proposed a revised NAAQS for ozone which would increase the stringency of the standard. In addition, the EPA published final revised NAAQS standards for NO<sub>2</sub> and SO<sub>2</sub> in February 2010 and June 2010, respectively, which are more stringent than previous standards. Depending on the level of action determined necessary to bring local nonattainment areas into compliance with the revised NAAQS standards, KU’s power plants are potentially subject to requirements for additional reductions in SO<sub>2</sub> and NO<sub>x</sub> emissions.

In July 2010, the EPA issued the proposed CATR, which serves to replace the CAIR. The CATR provides for a two-phase SO<sub>2</sub> reduction program with Phase I reductions due by 2012 and Phase II reductions due by 2014. The CATR provides for NO<sub>x</sub> reductions in 2012, but the EPA advised that it is studying whether additional NO<sub>x</sub> reductions should be required for 2014. The CATR is more stringent than the CAIR as it accelerates certain compliance dates and provides for only intrastate and limited interstate trading of emission allowances. In addition to its preferred approach, the EPA is seeking comment on an alternative approach which would provide for individual emission limits at each power plant. The EPA has announced that it will propose additional “transport” rules to address compliance with revised NAAQS standards for ozone and particulate matter which will be issued by the EPA in the future, as discussed below.

#### *Hazardous Air Pollutants*

As provided in the Clean Air Act, the EPA investigated hazardous air pollutant emissions from electric utilities and submitted a report to Congress identifying mercury emissions from coal-fired power plants as warranting further study. In 2005, the EPA issued the CAMR establishing mercury standards for new power plants and requiring all states to issue new SIPs including mercury requirements for existing power plants. The EPA issued a model rule which provides for a two-phase cap and trade program with initial reductions due by 2010 and final reductions due by 2018. The CAMR provided for reductions of

70% from 2003 levels. The EPA closely integrated the CAMR and CAIR programs to ensure that the 2010 mercury reduction targets would be achieved as a “co-benefit” of the controls installed for purposes of compliance with the CAIR.

In February 2008, a federal appellate court issued a decision vacating the CAMR. The EPA has entered into a consent decree requiring it to promulgate a utility Maximum Achievable Control Technology rule to replace the CAMR with a proposed rule due by March 2011 and a final rule by November 2011. Depending on the final outcome of the rulemaking, the CAMR could be replaced by new rules with different or more stringent requirements for reduction of mercury and other hazardous air pollutants. Kentucky has also repealed its corresponding state mercury regulations.

### *Acid Rain Program*

The Clean Air Act imposed a two-phased cap and trade program to reduce SO<sub>2</sub> emissions from power plants that were thought to contribute to “acid rain” conditions in the northeastern U.S. The Clean Air Act also contains requirements for power plants to reduce NO<sub>x</sub> emissions through the use of available combustion controls.

### *Regional Haze*

The Clean Air Act also includes visibility goals for certain federally designated areas, including national parks, and requires states to submit SIPs that will demonstrate reasonable progress toward preventing future impairment and remedying any existing impairment of visibility in those areas. In 2005, the EPA issued its Clean Air Visibility Rule detailing how the Clean Air Act’s BART requirements will be applied to facilities, including power plants built between 1962 and 1974 that emit certain levels of visibility impairing pollutants. Under the final rule, as the CAIR provided for more visibility improvement than BART, states are allowed to substitute CAIR requirements in their regional haze SIPs in lieu of controls that would otherwise be required by BART. The final rule has been challenged in the courts. Additionally, because the regional haze SIPs incorporate certain CAIR requirements, the remand of the CAIR could potentially impact regional haze SIPs. See “Ambient Air Quality” above for a discussion of CAIR-related uncertainties.

### *Installation of Pollution Controls*

Many of the programs under the Clean Air Act utilize cap and trade mechanisms that require a company to hold sufficient emissions allowances to cover its authorized emissions on a company-wide basis and do not require installation of pollution controls on every generating unit. Under cap and trade programs, companies are free to focus their pollution control efforts on plants where such controls are particularly efficient and utilize the resulting emission allowances for smaller plants where such controls are not cost effective. KU met its Phase I SO<sub>2</sub> requirements primarily through installation of FGD equipment on Ghent Unit 1. KU’s strategy for its Phase II SO<sub>2</sub> requirements, which commenced in 2000, includes the installation of additional FGD equipment, as well as using accumulated emission allowances and fuel switching to defer certain additional capital expenditures and continue to evaluate improvements to further reduce SO<sub>2</sub> emissions. KU believes its costs in reducing SO<sub>2</sub>, NO<sub>x</sub> and mercury emissions to be comparable to those of similarly situated utilities with like generation assets. KU’s compliance plans are subject to many factors including developments in the emission allowance and fuels markets, future legislative and regulatory enactments, legal proceedings and advances in clean air technology. KU will



continue to monitor these developments to ensure that its environmental obligations are met in the most efficient and cost-effective manner. KU expects to incur additional capital expenditures currently approved in its ECR plans totaling approximately \$500 million during the 2011 through 2013 time period to achieve emissions reductions and manage coal combustion residuals. Monthly recovery is subject to periodic review by the Kentucky Commission.

### *GHG Developments*

In 2005, the Kyoto Protocol for reducing GHG emissions took effect, obligating 37 industrialized countries to undertake substantial reductions in GHG emissions. The U.S. has not ratified the Kyoto Protocol and there are currently no mandatory GHG emission reduction requirements at the federal level. As discussed below, legislation mandating GHG reductions has been introduced in the Congress, but no federal legislation has been enacted to date. In the absence of a program at the federal level, various states have adopted their own GHG emission reduction programs, including 11 northeastern U.S. states and the District of Columbia under the Regional GHG Initiative program and California. Substantial efforts to pass federal GHG legislation are on-going. The current administration has announced its support for the adoption of mandatory GHG reduction requirements at the federal level. The United States and other countries met in Copenhagen, Denmark, in December 2009, in an effort to negotiate a GHG reduction treaty to succeed the Kyoto Protocol, which is set to expire in 2013. In Copenhagen, the U.S. made a nonbinding commitment to, among other things, seek to reduce GHG emissions to 17% below 2005 levels by 2020 and provide financial support to developing countries. The United States and other nations met in Cancun, Mexico, in December 2010 to continue negotiations toward a binding agreement.

### *GHG Legislation*

KU is monitoring on-going efforts to enact GHG reduction requirements and requirements governing carbon sequestration at the state and federal level and is assessing potential impacts of such programs and strategies to mitigate those impacts. In June 2009, the U.S. House of Representatives passed the American Clean Energy and Security Act of 2009, which was a comprehensive energy bill containing the first-ever nation-wide GHG cap and trade program. The bill provided for reductions in GHG emissions of 3% below 2005 levels by 2012, 17% by 2020 and 83% by 2050. In order to cushion potential rate impacts for utility customers, approximately 43% of emissions allowances would have initially been allocated at no cost to the electric utility sector, with this allocation gradually declining to 7% in 2029 and zero thereafter. The bill would have also established a renewable electricity standard requiring utilities to meet 20% of their electricity demand through renewable energy and energy efficiency by 2020. The bill contained additional provisions regarding carbon capture and sequestration, clean transportation, smart grid advancement, nuclear and advanced technologies and energy efficiency.

In September 2009, the Clean Energy Jobs and American Power Act, which was largely patterned on the House legislation, was introduced in the U.S. Senate. The Senate bill raised the emissions reduction target for 2020 to 20% below 2005 levels and did not include a renewable electricity standard. While the initial bill lacked detailed provisions for the allocation of emissions allowances, a subsequent revision incorporated allowance allocation provisions similar to the House bill. Although Senators Kerry and Lieberman and others worked to reach a consensus on GHG legislation, no bill passed the Senate in 2010. The Company is closely monitoring the progress of pending energy legislation, but the prospect for passage of comprehensive GHG legislation in 2011 is uncertain.

### *GHG Regulations*

In April 2007, the U.S. Supreme Court ruled that the EPA has the authority to regulate GHG under the Clean Air Act. In April 2009, the EPA issued a proposed endangerment finding concluding that GHGs endanger public health and welfare, which is an initial rulemaking step under the Clean Air Act. A final endangerment finding was issued in December 2009. In September 2009, the EPA issued a final GHG reporting rule requiring reporting by facilities with annual GHG emissions equivalent to at least 25,000 tons of carbon dioxide. A number of the Company's facilities are required to submit annual reports commencing with calendar year 2010. In May 2010, the EPA issued a final GHG "tailoring" rule, effective January 2011, requiring new or modified sources with GHG emissions equivalent to at least 75,000 tons of carbon dioxide to obtain permits under the Prevention of Significant Deterioration Program. Such new or modified facilities would be required to install Best Available Control Technology. While the Company is unaware of any currently available GHG control technology that might be required for installation on new or modified power plants, it is currently assessing the potential impact of the rule. The final rule will apply to new and modified power plants beginning in January 2011. The Company is unable to predict whether mandatory GHG reduction requirements will ultimately be enacted through legislation or regulations. In December 2010, the EPA announced that it plans to promulgate GHG New Source Performance Standards for power plants, including both new and existing facilities. A proposed rule is expected by July 2011, while a final rule is expected by May 2012. In the absence of either a proposed or final regulation, KU is unable to assess the potential impact of any future regulation.

### *GHG Litigation*

A number of lawsuits have been filed asserting common law claims including nuisance, trespass and negligence against various companies with GHG emitting facilities. In October 2009, a three judge panel of the United States Court of Appeals for the 5<sup>th</sup> Circuit in the case of *Comer v. Murphy Oil* reversed a lower court, holding that private plaintiffs have standing to assert certain common law claims against more than 30 utility, oil, coal and chemical companies. In March 2010, the court vacated the opinion of the three-judge panel and granted a motion for rehearing but subsequently denied the appeal due to the lack of a quorum. The appellate ruling leaves in effect the lower court ruling dismissing the plaintiffs' claims. In January 2011, the Supreme Court denied petitioner's petition for review, which effectively brings the case to an end. The *Comer* complaint alleged that GHG emissions from the defendants' facilities contributed to global warming which increased the intensity of Hurricane Katrina. E.ON, the former indirect parent of the Utilities, was named as a defendant in the complaint but was not a party to the proceedings due to the failure of the plaintiffs to pursue service under the applicable international procedures. KU continues to monitor relevant GHG litigation to identify judicial developments that may be potentially relevant to operations.

### *Ghent Opacity NOV*

In September 2007, the EPA issued an NOV alleging that KU had violated certain provisions of the Clean Air Act's operating rules relating to opacity during June and July of 2007 at Units 1 and 3 of KU's Ghent generating station. The parties have met on this matter and KU has received no further communications from the EPA. The Company is not able to estimate the outcome or potential effects of these matters, including whether substantial fines, penalties or remedial measures may result.

### *Ghent New Source Review NOV*

In March 2009, the EPA issued an NOV alleging that KU violated certain provisions of the Clean Air Act's rules governing new source review and prevention of significant deterioration by installing FGD and SCR controls at its Ghent generating station without assessing potential increased sulfuric acid mist emissions. KU contends that the work in question, as pollution control projects, was exempt from the requirements cited by the EPA. In December 2009, the EPA issued a Section 114 information request seeking additional information on this matter. In March 2010, the Company received an EPA settlement proposal providing for imposition of additional permit limits and emission controls and anticipates continued settlement negotiations with the EPA. Negotiations between the EPA and KU are ongoing. Depending on the provisions of a final settlement or the results of litigation, if any, resolution of this matter could involve significant increased operating and capital expenditures. The Company is currently unable to determine the final outcome of this matter or the impact of an unfavorable determination on the Company's financial position or results of operations.

### *Ash Ponds and Coal-Combustion Byproducts*

The EPA has undertaken various initiatives in response to the December 2008 impoundment failure at the TVA's Kingston power plant, which resulted in a major release of coal combustion byproducts into the environment. The EPA issued information requests to utilities throughout the country, including KU, to obtain information on their ash ponds and other impoundments. In addition, the EPA inspected a large number of impoundments located at power plants to determine their structural integrity. The inspections included several of KU's impoundments, which the EPA found to be in satisfactory condition. In June 2010, the EPA published proposed regulations for coal combustion byproducts handled in landfills and ash ponds. The EPA has proposed two alternatives: (1) regulation of coal combustion byproducts in landfills and ash ponds as a hazardous waste or (2) regulation of coal combustion byproducts as a solid waste with minimum national standards. Under both alternatives, the EPA has proposed safety requirements to address the structural integrity of ash ponds. In addition, the EPA will consider potential refinements of the provisions for beneficial reuse of coal combustion byproducts.

### *Water Discharges and PCB Regulations*

The EPA has also announced plans to develop revised effluent limitation guidelines governing discharges from power plants and standards for cooling water intake structures. The EPA has further announced plans to develop revised standards governing the use of polychlorinated biphenyls ("PCB") in electrical equipment. The Company is monitoring these ongoing regulatory developments but will be unable to determine the impact until such time as new rules are finalized.

### *Impact of Pending and Future Environmental Developments*

As a company with significant coal-fired generating assets, KU will likely be substantially impacted by pending or future environmental rules or legislation requiring mandatory reductions in GHG emissions or other air emissions, imposing more stringent standards on discharges to waterways, or establishing additional requirements for handling or disposal of coal combustion byproducts. These evolving environmental regulations will likely require an increased level of capital expenditures and increased incremental operating and maintenance costs by the Company over the next several years. Due to the uncertain nature of the final regulations that will ultimately be adopted by the EPA, including the

reduction targets and the deadlines that will be applicable, the Company cannot finalize estimates of the potential compliance costs, but should the final rules incorporate additional emission reduction requirements, require more stringent emissions controls or implement more stringent byproducts storage and disposal practices, such costs will likely be significant. With respect to NAAQS, CATR, CAMR replacement and coal combustion byproducts developments, based upon a preliminary analysis of proposed regulations, the Company may be required to consider actions such as upgrading existing emissions controls, installing additional emissions controls, upgrading byproducts disposal and storage and possible early replacement of coal-fired units. Capital expenditures for KU associated with such actions are preliminarily estimated to be in the \$1.5 to \$1.7 billion range over the next ten years, although final costs may substantially vary. With respect to potential developments in water discharge, revised PCB standards or GHG initiatives, costs in such areas cannot be estimated due to the preliminary status or uncertain outcome of such developments, but would be in addition to the above amount and could be substantial. Ultimately, the precise impact on the Company's operations of these various environmental developments cannot be determined prior to the finalization of such requirements. Based upon prior regulatory precedent, the Company believes that many costs of complying with such pending or future requirements would likely be recoverable under the ECR or other potential cost-recovery mechanisms, but the Company can provide no assurance as to the ultimate outcome of such proceedings before the regulatory authorities.

#### *TC2 Water Permit*

In May 2010, the Kentucky Waterways Alliance and other environmental groups filed a petition with the Kentucky Energy and Environment Cabinet challenging the Kentucky Pollutant Discharge Elimination System permit issued in April 2010, which covers water discharges from the Trimble County generating station. In October 2010, the hearing officer issued a report and recommended Order providing for dismissal of the claims raised by the petitioners. In December 2010, the Secretary issued a final Order dismissing all claims and upholding the permit which petitioners subsequently appealed to Trimble County Circuit Court.

#### *General Environmental Proceedings*

From time to time, KU appears before the EPA, various state or local regulatory agencies and state and federal courts regarding matters involving compliance with applicable environmental laws and regulations. Such matters include a prior Section 114 information request from the EPA relating to new-source review issues at KU's Ghent unit 2; completed settlement with state regulators regarding compliance with particulate limits in the air permit for KU's Tyrone generating station; remediation obligations or activities for or other risks relating to elevated PCB levels at existing properties; liability under the Comprehensive Environmental Response, Compensation and Liability Act for cleanup at various off-site waste sites; and on-going claims regarding the GHG emissions from the Company's generating stations. Based on analysis to date, the resolution of these matters is not expected to have a material impact on the Company's operations.

## Note 14 - Jointly Owned Electric Utility Plant

TC2 is a jointly owned unit at the Trimble County site. KU and LG&E own undivided 60.75% and 14.25% interests, respectively. Of the remaining 25%, IMEA owns a 12.12% undivided interest and IMPA owns a 12.88% undivided interest. Each company is responsible for its proportionate share of capital cost during construction and fuel, operation and maintenance cost when TC2 is in-service. With limited exceptions the Company took care, custody and control of TC2 on January 22, 2011, and has dispatched the unit to meet customer demand since that date. KU and the contractor agreed to a further amendment of the construction agreement whereby the contractor will complete certain actions relating to identifying and completing any necessary modifications to allow operation of TC2 on all fuels in accordance with initial specifications prior to certain dates, and amending the provisions relating to liquidated damages. In December 2009 and June 2008, LG&E sold assets to KU related to the construction of TC2 with a net book value of \$48 million and \$10 million, respectively.

The following data represent shares of the jointly owned property (capacity based on nameplate rating):

	TC2				
	KU	LG&E	IMPA	IMEA	Total
Ownership interest	60.75%	14.25%	12.88%	12.12%	100%
Mw capacity	509	119	108	102	838

KU's 60.75% ownership:

Plant held for future use	\$ 62
Construction work in progress	703
Accumulated depreciation	(1)
Net book value	<u>\$ 764</u>

LG&E's 14.25% ownership:

Plant held for future use	\$ 2
Construction work in progress	187
Accumulated depreciation	-
Net book value	<u>\$ 189</u>

KU and LG&E jointly own the following CTs and related equipment (capacity based on net summer capability) as of December 31, 2010:

Ownership Percentage	KU				LG&E				Total			
	Mw Capacity	Cost	Depr.	Net Book Value	Mw Capacity	Cost	Depr.	Net Book Value	Mw Capacity	Cost	Depr.	Net Book Value
KU 47%, LG&E 53% (a)	129	\$ 43	\$ -	\$ 43	146	\$ 48	\$ -	\$ 48	275	\$ 91	\$ -	\$ 91
KU 62%, LG&E 38% (b)	190	64	(2)	62	118	40	(2)	38	308	104	(4)	100
KU 71%, LG&E 29% (c)	228	63	(1)	62	92	26	-	26	320	89	(1)	88
KU 63%, LG&E 37% (d)	404	109	(1)	108	236	64	(1)	63	640	173	(2)	171
KU 71%, LG&E 29% (e)	n/a	4	-	4	n/a	2	-	2	n/a	6	-	6

- (a) Comprised of Paddy's Run 13 and E.W. Brown 5. In addition to the above jointly owned utility plant, there is an inlet air cooling system attributable to unit 5 and units 8-11 at the E.W. Brown facility. This inlet air cooling system is not jointly owned, however, it is used to increase production on the units to which it relates, resulting in an additional 88 Mw of capacity for KU.

- (b) Comprised of units 6 and 7 at the E.W. Brown facility.
- (c) Comprised of units 5 and 6 at the Trimble County facility.
- (d) Comprised of CT Substation 7-10 and units 7, 8, 9 and 10 at the Trimble County facility.
- (e) Comprised of CT Substation 5 and 6 and CT Pipeline at the Trimble County facility.

Both KU's and LG&E's participating share of direct expenses of the jointly owned plants is included in the corresponding operating expenses on each company's respective Statements of Income (i.e., fuel, maintenance of plant, other operating expense).

#### Note 15 - Related Party Transactions

KU and subsidiaries of LKE and PPL engage in related party transactions. Transactions between KU and LKE subsidiaries are eliminated on consolidation of LKE. Transactions between KU and PPL subsidiaries are eliminated on consolidation of PPL. These transactions are generally performed at cost and are in accordance with FERC regulations under PUHCA 2005 and the applicable Kentucky Commission and Virginia Commission regulations.

#### Intercompany Wholesale Sales and Purchases

KU and LG&E jointly dispatch their generation units with the lowest cost generation used to serve their retail native load. When LG&E has excess generation capacity after serving its own retail native load and its generation cost is lower than that of KU, KU purchases electricity from LG&E. When KU has excess generation capacity after serving its own retail native load and its generation cost is lower than that of LG&E, LG&E purchases electricity from KU. These transactions are recorded as intercompany wholesale sales and purchases are recorded by each company at a price equal to the seller's fuel cost. Savings realized from purchasing electricity intercompany instead of generating from their own higher costs units or purchasing from the market are shared equally between the Utilities. The volume of energy each company has to sell to the other is dependent on its native load needs and its available generation.

These sales and purchases are included in the Statements of Income as "Operating revenues", "Power purchased" expenses and "Other operation and maintenance expenses". KU's intercompany electric revenues and power purchased expenses were as follows:

	Successor	Predecessor		
	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31, 2009      2008	
Electric operating revenues from LG&E	\$      2	\$      13	\$      21	\$      80
Power purchased and related operations and maintenance expenses from LG&E	21	79	101	109

### Interest Charges

See Note 11, Long-Term Debt, and Note 12, Notes Payable and Other Short-Term Obligations, for details of intercompany borrowing arrangements. Intercompany agreements do not require interest payments for receivables related to services provided when settled within 30 days.

KU's interest expense to affiliated companies was as follows:

	Successor	Predecessor		
	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31,	
			2009	2008
Interest on money pool loans	\$ -	\$ -	\$ -	\$ 2
Interest on PPL loans	2	-	-	-
Interest on Fidelia loans	-	62	69	56

Interest paid to LKE on the money pool arrangement was less than \$1 million for 2010 and 2009.

### Dividends

In September 2010, the Company paid dividends of \$50 million to its sole shareholder, LKE.

### Capital Contributions

The Company received no capital contributions in 2010, but received capital contributions of \$75 million and \$145 million from its sole shareholder, LKE, in 2009 and 2008, respectively.

### Sale of Assets

In 2010, KU sold and bought assets of less than \$1 million to and from LG&E. In December 2009, LG&E sold assets to KU related to the construction of TC2 with a net book value of \$48 million.

### Other Intercompany Billings

Servco provides the Company with a variety of centralized administrative, management and support services. Associated charges include payroll taxes paid by Servco on behalf of KU, labor and burdens of Servco employees performing services for KU, coal purchases and other vouchers paid by Servco on behalf of KU. The cost of these services is directly charged to the Company, or for general costs which cannot be directly attributed, charged based on predetermined allocation factors, including the following ratios: number of customers, total assets, revenues, number of employees and/or other statistical information. These costs are charged on an actual cost basis.

In addition, the Utilities provide services to each other and to Servco. Billings between the Utilities relate to labor and overheads associated with union and hourly employees performing work for the other utility, charges related to jointly-owned generating units and other miscellaneous charges. Billings from KU to Servco include cash received by Servco on behalf of KU, tax settlements and other payments

made by the Company on behalf of other non-regulated businesses which are reimbursed through Servco.

Intercompany billings to and from KU were as follows:

	Successor	Predecessor		
	November 1, 2010 through December 31, 2010	January 1, 2010 through October 31, 2010	Year Ended December 31,	
			2009	2008
Servco billings to KU	\$ 46	\$ 233	\$ 169	\$ 227
LG&E billings to KU	14	49	44	5
KU billings to Servco	12	11	14	3
KU billings to LG&E	-	-	78	75

Intercompany Balances

The Company had the following balances with its affiliates:

	Successor	Predecessor
	December 31, 2010	December 31, 2009
Accounts receivable from LKE	\$ 12	\$ 9
Accounts payable to LG&E	22	53
Accounts payable to Servco	23	20
Accounts payable to Fidelia	-	15
Notes payable to LKE	10	45
Long-term debt to Fidelia	-	1,331

**Note 16 - Selected Quarterly Data (Unaudited)**

	For the 2010 Periods Ended (a)					Successor December 31
	Predecessor				December 31	
	March 31	June 30	September 30	October 31		
Operating revenues	\$ 380	\$ 350	\$ 416	\$ 102	\$ 263	
Operating income	87	71	105	22	65	
Net income	44	31	54	11	35	

(a) Periods ended March 31, June 30 and September 30 represent three months then ended. Period ended October 31 represents one month then ended and period ended December 31 represents two months then ended.



	For the 2009 Quarters Ended			
	Predecessor			
	March 31	June 30	September 30	December 31
Operating revenues	\$ 363	\$ 305	\$ 341	\$ 346
Operating income	19	53	125	72
Net income	7	26	66	34

**Note 17 - Accumulated Other Comprehensive Income (Loss)**

Accumulated other comprehensive income (loss) consisted of the following:

	Pre-Tax Accumulated Derivative Gain (Loss)	Income Taxes	Net
Balance at December 31, 2009, Predecessor	\$ -	\$ -	\$ -
Equity investee's other comprehensive income (loss)	(3)	1	(2)
Balance at October 31, 2010, Predecessor	(3)	1	(2)
Effect of PPL acquisition	3	(1)	2
Balance at December 31, 2010, Successor	\$ -	\$ -	\$ -

**Note 18 - Subsequent Events**

Subsequent events have been evaluated through February 25, 2011, the date of issuance of these statements. These statements contain all necessary adjustments and disclosures resulting from that evaluation.

On January 31, 2011, KU filed a notice of intent to file a rate case with the Virginia Commission for the test year ended December 31, 2010. The case is expected to be filed on or after April 1, 2011.

With limited exceptions the Company took care, custody and control of TC2 on January 22, 2011, and has dispatched the unit to meet customer demand since that date. LG&E and KU and the contractor agreed to a further amendment of the construction agreement whereby the contractor will complete certain actions relating to identifying and completing any necessary modifications to allow operation of TC2 on all fuels in accordance with initial specifications prior to certain dates, and amending the provisions relating to liquidated damages.

On January 14, 2011, KU contributed \$43 million to its pension plan.



## Report of Independent Auditors

To Stockholder of Kentucky Utilities Company

In our opinion, the accompanying balance sheet and the related statements of income, retained earnings, comprehensive income, cash flows, and capitalization present fairly, in all material respects, the financial position of Kentucky Utilities Company (Successor Company) at December 31, 2010 and the results of its operations and its cash flows for the period from November 1, 2010 to December 31, 2010 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assertion of the effectiveness of internal control over financial reporting, included in "Management's Report of Internal Controls Over Financial Reporting" which appears on page 50. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audit. We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States) and in accordance with the auditing and attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audit of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 2 to the financial statements, on November 1, 2010, PPL Corporation completed its acquisition of LG&E and KU Energy LLC and its subsidiaries. The push-down basis of accounting was used at the acquisition date.

A company's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial

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statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and those charged with governance and (iii) provide reasonable assurance regarding prevention or timely detection and correction of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect and correct misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

*PricewaterhouseCoopers LLP*

Louisville, Kentucky  
February 25, 2011



## Report of Independent Auditors

To Stockholder of Kentucky Utilities Company

In our opinion, the accompanying balance sheet and the related statements of income, retained earnings, comprehensive income, cash flows, and capitalization present fairly, in all material respects, the financial position of Kentucky Utilities Company (Predecessor Company) at December 31, 2009 and the results of its operations and its cash flows for the period from January 1, 2010 to October 31, 2010 and for each of the two years in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2 to the financial statements, on November 1, 2010, PPL Corporation completed its acquisition of LG&E and KU Energy LLC and its subsidiaries. The push-down basis of accounting was used at the acquisition date.

*PricewaterhouseCoopers LLP*

Louisville, Kentucky

February 25, 2011



# PPL ELECTRIC UTILITIES CORP

## FORM 10-K (Annual Report)

Filed 02/26/10 for the Period Ending 12/31/09

Address	TWO N NINTH ST ALLENTOWN, PA 18101
Telephone	6107745151
CIK	0000317187
Symbol	PLEUI
SIC Code	4911 - Electric Services
Fiscal Year	12/31

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-K**

- [X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the fiscal year ended December 31, 2009
- OR
- [ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the transition period from \_\_\_\_\_ to \_\_\_\_\_

<u>Commission File Number</u>	<u>Registrant; State of Incorporation; Address and Telephone Number</u>	<u>IRS Employer Identification No.</u>
1-11459	<b>PPL Corporation</b> (Exact name of Registrant as specified in its charter) (Pennsylvania) Two North Ninth Street Allentown, PA 18101-1179 (610) 774-5151	23-2758192
1-32944	<b>PPL Energy Supply, LLC</b> (Exact name of Registrant as specified in its charter) (Delaware) Two North Ninth Street Allentown, PA 18101-1179 (610) 774-5151	23-3074920
1-905	<b>PPL Electric Utilities Corporation</b> (Exact name of Registrant as specified in its charter) (Pennsylvania) Two North Ninth Street Allentown, PA 18101-1179 (610) 774-5151	23-0959590

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Stock of PPL Corporation	New York Stock Exchange
Senior Notes of PPL Energy Supply, LLC 7.0% due 2046	New York Stock Exchange
Preferred Stock of PPL Electric Utilities Corporation 4-1/2% 4.40% Series	New York Stock Exchange New York Stock Exchange
Junior Subordinated Notes of PPL Capital Funding, Inc. 2007 Series A due 2067	New York Stock Exchange
Senior Notes of PPL Capital Funding, Inc. 6.85% due 2047	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the Registrants are well-known seasoned issuers, as defined in Rule 405 of the Securities Act.

PPL Corporation	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>
PPL Energy Supply, LLC	Yes <input type="checkbox"/>	No <input checked="" type="checkbox"/>
PPL Electric Utilities Corporation	Yes <input type="checkbox"/>	No <input checked="" type="checkbox"/>

Indicate by check mark if the Registrants are not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

PPL Corporation	Yes <input type="checkbox"/>	No <input checked="" type="checkbox"/>
PPL Energy Supply, LLC	Yes <input type="checkbox"/>	No <input checked="" type="checkbox"/>
PPL Electric Utilities Corporation	Yes <input type="checkbox"/>	No <input checked="" type="checkbox"/>

Indicate by check mark whether the Registrants (1) have filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrants were required to file such reports), and (2) have been subject to such filing requirements for the past 90 days.

PPL Corporation	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>
PPL Energy Supply, LLC	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>
PPL Electric Utilities Corporation	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>

Indicate by check mark whether the Registrants have submitted electronically and posted on their corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrants were required to submit and post such files).

PPL Corporation	Yes <input checked="" type="checkbox"/>	No <input type="checkbox"/>
PPL Energy Supply, LLC	Yes <input type="checkbox"/>	No <input type="checkbox"/>
PPL Electric Utilities Corporation	Yes <input type="checkbox"/>	No <input type="checkbox"/>

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrants' knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

PPL Corporation	<input checked="" type="checkbox"/>
PPL Energy Supply, LLC	<input checked="" type="checkbox"/>
PPL Electric Utilities Corporation	<input checked="" type="checkbox"/>

Indicate by check mark whether the Registrants are large accelerated filers, accelerated filers, non-accelerated filers, or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

	Large accelerated filer	Accelerated filer	Non-accelerated filer	Smaller reporting company
PPL Corporation	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
PPL Energy Supply, LLC	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>
PPL Electric Utilities Corporation	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>

Indicate by check mark whether the Registrants are shell companies (as defined in Rule 12b-2 of the Act).

PPL Corporation	Yes <input type="checkbox"/>	No <input checked="" type="checkbox"/>
PPL Energy Supply, LLC	Yes <input type="checkbox"/>	No <input checked="" type="checkbox"/>
PPL Electric Utilities Corporation	Yes <input type="checkbox"/>	No <input checked="" type="checkbox"/>

As of June 30, 2009, PPL Corporation had 376,144,172 shares of its \$.01 par value Common Stock outstanding. The aggregate market value of these common shares (based upon the closing price of these shares on the New York Stock Exchange on that date) held by non-affiliates was \$12,397,711,909. As of January 29, 2010, PPL Corporation had 377,900,179 shares of its \$.01 par value Common Stock outstanding.

As of January 29, 2010, PPL Corporation held all 66,368,056 outstanding common shares, no par value, of PPL Electric Utilities Corporation.

PPL Corporation indirectly holds all of the membership interests in PPL Energy Supply, LLC.

**PPL Energy Supply, LLC meets the conditions set forth in General Instructions (I)(1)(a) and (b) of Form 10-K and is therefore filing this form with the reduced disclosure format.**

Documents incorporated by reference:

PPL Corporation and PPL Electric Utilities Corporation have incorporated herein by reference certain sections of PPL Corporation's 2010 Notice of Annual Meeting and Proxy Statement, and PPL Electric Utilities Corporation's 2010 Notice of Annual Meeting and Information Statement, which will be filed with the Securities and Exchange Commission not later than 120 days after December 31, 2009. Such Statements will provide the information required by Part III of this Report.



**PPL CORPORATION  
PPL ENERGY SUPPLY, LLC  
PPL ELECTRIC UTILITIES CORPORATION**

FORM 10-K ANNUAL REPORT TO  
THE SECURITIES AND EXCHANGE COMMISSION  
FOR THE YEAR ENDED DECEMBER 31, 2009

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This combined Form 10-K is separately filed by PPL Corporation, PPL Energy Supply, LLC and PPL Electric Utilities Corporation. Information contained herein relating to PPL Energy Supply, LLC and PPL Electric Utilities Corporation is filed by PPL Corporation and separately by PPL Energy Supply, LLC and PPL Electric Utilities Corporation on their own behalf. No registrant makes any representation as to information relating to any other registrant, except that information relating to the two PPL Corporation subsidiaries is also attributed to PPL Corporation.

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## GLOSSARY OF TERMS AND ABBREVIATIONS

### PPL Corporation and its current and former subsidiaries

**Emel** - Empresas Emel S.A., a Chilean electric distribution holding company in which PPL Global had a majority ownership interest until its sale in November 2007.

**Hyder** - Hyder Limited, a subsidiary of WPD that was the previous owner of South Wales Electricity plc. In March 2001, South Wales Electricity plc was acquired by WPDH Limited and renamed WPD (South Wales).

**PPL** - PPL Corporation, the parent holding company of PPL Electric, PPL Energy Funding and other subsidiaries.

**PPL Capital Funding** - PPL Capital Funding, Inc., a financing subsidiary of PPL.

**PPL Electric** - PPL Electric Utilities Corporation, a regulated utility subsidiary of PPL that transmits and distributes electricity in its service territory and provides electric supply to retail customers in this territory as a PLR.

**PPL Energy Funding** - PPL Energy Funding Corporation, a subsidiary of PPL and the parent company of PPL Energy Supply.

**PPL EnergyPlus** - PPL EnergyPlus, LLC, a subsidiary of PPL Energy Supply that markets and trades wholesale and retail electricity and gas, and supplies energy and energy services in deregulated markets.

**PPL Energy Supply** - PPL Energy Supply, LLC, a subsidiary of PPL Energy Funding and the parent company of PPL Generation, PPL EnergyPlus, PPL Global and other subsidiaries.

**PPL Gas Utilities** - PPL Gas Utilities Corporation, a regulated utility that provided natural gas distribution, transmission and storage services, and the competitive sale of propane, which was a subsidiary of PPL until its sale in October 2008.

**PPL Generation** - PPL Generation, LLC, a subsidiary of PPL Energy Supply that owns and operates U.S. generating facilities through various subsidiaries.

**PPL Global** - PPL Global, LLC, a subsidiary of PPL Energy Supply that primarily owns and operates a business in the U.K., WPD, that is focused on the regulated distribution of electricity.

**PPL Holtwood** - PPL Holtwood, LLC, a subsidiary of PPL Generation that owns hydroelectric generating operations in Pennsylvania.

**PPL Investment Corp.** - PPL Investment Corporation, a subsidiary of PPL Energy Supply.

**PPL Maine** - PPL Maine, LLC, a subsidiary of PPL Generation that owns generating operations in Maine.

**PPL Martins Creek** - PPL Martins Creek, LLC, a subsidiary of PPL Generation that owns generating operations in Pennsylvania.

**PPL Montana** - PPL Montana, LLC, an indirect subsidiary of PPL Generation that generates electricity for wholesale sales in Montana and the Pacific Northwest.

**PPL Services** - PPL Services Corporation, a subsidiary of PPL that provides shared services for PPL and its subsidiaries.

**PPL Susquehanna** - PPL Susquehanna, LLC, the nuclear generating subsidiary of PPL Generation.

**PPL Transition Bond Company** - PPL Transition Bond Company, LLC, a subsidiary of PPL Electric that was formed to issue transition bonds under the Customer Choice Act. This subsidiary was dissolved in June 2009.

**SIUK Capital Trust I** - a business trust created to issue preferred securities, the common equity of which was held by WPD LLP. The preferred securities were redeemed in February 2007.

**WPD** - refers collectively to WPDH Limited and WPD.

**WPD LLP** - Western Power Distribution LLP, a wholly owned subsidiary of WPDH Limited, which owns WPD (South West) and WPD (South Wales).

**WPD (South Wales)** - Western Power Distribution (South Wales) plc, a British regional electric utility company.

**WPD (South West)** - Western Power Distribution (South West) plc, a British regional electric utility company.

**WPDH Limited** - Western Power Distribution Holdings Limited, an indirect, wholly owned subsidiary of PPL Global. WPDH Limited owns WPD LLP.

**WPD Investment Holdings Limited** - WPD Investment Holdings Limited, an indirect wholly owned subsidiary of PPL Global. WPD Investment Holdings Limited owns 100% of the common shares

of Hyder.

**Other terms and abbreviations**

**'01(h) account** - A sub-account established within a qualified pension trust to provide for the payment of retiree medical costs.

**£** - British pounds sterling.

**1945 First Mortgage Bond Indenture** - PPL Electric's Mortgage and Deed of Trust, dated as of October 1, 1945, to Deutsche Bank Trust Company Americas, as trustee, as supplemented.

**2001 Senior Secured Bond Indenture** - PPL Electric's Indenture, dated as of August 1, 2001, to The Bank of New York Mellon (as successor to JPMorgan Chase Bank), as trustee, as supplemented.

**AFUDC** (Allowance for Funds Used During Construction) - the cost of equity and debt funds used to finance construction projects of regulated businesses, which is capitalized as part of construction cost.

**A.M. Best** - A.M. Best Company, a company that reports on the condition of insurance companies.

**AMT** - alternative minimum tax.

**AOI** - accumulated other comprehensive income or loss.

**ARO** - asset retirement obligation.

**Baseload generation** - includes the output provided by PPL's nuclear, coal, hydroelectric and qualifying facilities.

**Basis** - when used in the context of derivatives and commodity trading, the commodity price differential between two locations, products or time periods.

**Bcf** - billion cubic feet.

**Black Lung Trust** - a trust account maintained under federal and state Black Lung legislation for the payment of claims related to disability or death due to pneumoconiosis.

**CAIR** - the EPA's Clean Air Interstate Rule.

**Clean Air Act** - federal legislation enacted to address certain environmental issues related to air emissions, including acid rain, ozone and toxic air emissions.

**COLA** - license application for a combined construction permit and operating license from the NRC.

**CTC** - competitive transition charge on customer bills to recover allowable transition costs under the Customer Choice Act.

**Customer Choice Act** - the Pennsylvania Electricity Generation Customer Choice and Competition Act, legislation enacted to restructure the state's electric utility industry to create retail access to a competitive market for generation of electricity.

**DDCP** - Directors Deferred Compensation Plan.

**DEP** - Department of Environmental Protection, a state government agency.

**DOE** - Department of Energy, a U.S. government agency.

**DRIP** - Dividend Reinvestment Plan.

**Economic Stimulus Package** - The American Recovery and Reinvestment Act of 2009, generally referred to as the federal economic stimulus package, which was signed into law in February 2009.

**EMF** - electric and magnetic fields.

**EPA** - Environmental Protection Agency, a U.S. government agency.

**EPS** - earnings per share.

**ESOP** - Employee Stock Ownership Plan.

**EWG** - exempt wholesale generator.

**FASB** - Financial Accounting Standards Board, a rulemaking organization that establishes financial accounting and reporting standards.

**FERC** - Federal Energy Regulatory Commission, the federal agency that regulates, among other things, interstate transmission and wholesale sales of electricity, hydroelectric power projects and related matters.

**Fitch** - Fitch, Inc.

**FTR** - financial transmission rights, which are financial instruments established to manage price risk related to electricity transmission congestion. They entitle the holder to receive compensation or require the holder to remit payment for certain congestion-related transmission charges that arise when the transmission grid is congested.

**GAAP** - generally accepted accounting principles in the U.S.

**GWh** - gigawatt-hour, one million kilowatt-hours.

**HMRC** - HM Revenue & Customs. The tax authority in the U.K., formerly known as Inland Revenue.

**IBEW** - International Brotherhood of Electrical Workers.

**ICP** - Incentive Compensation Plan.

**ICPKE** - Incentive Compensation Plan for Key Employees.

**Intermediate and peaking generation** - includes the output provided by PPL Energy Supply's oil- and natural gas-fired units.

**Ironwood** - a natural gas-fired power plant in Lebanon, Pennsylvania with a winter rating of 759 MW.

**IRS** - Internal Revenue Service, a U.S. government agency.

**IRC Sec. 481** - the Internal Revenue Code Section that prescribes the tax year in which adjustments to taxable income resulting from a change in a tax accounting method must be recognized.

**ISO** - Independent System Operator.

**TC** - intangible transition charge on customer bills to recover intangible transition costs associated with securitizing stranded costs under the Customer Choice Act.

**kVA** - kilovolt-ampere.

**kWh** - kilowatt-hour, basic unit of electrical energy.

**LCIDA** - Lehigh County Industrial Development Authority.

**LIBOR** - London Interbank Offered Rate.

**Long Island generation business** - includes a 79.9 MW gas-fired plant in the Edgewood section of Brentwood, New York and a 79.9 MW oil-fired plant in Shoreham, New York.

**MACT** - maximum achievable control technology.

**Montana Power** - The Montana Power Company, a Montana-based company that sold its generating assets to PPL Montana in December 1999. Through a series of transactions consummated during the first quarter of 2002, Montana Power sold its electricity delivery business to NorthWestern.

**Moody's** - Moody's Investors Service, Inc.

**MW** - megawatt, one thousand kilowatts.

**MWh** - megawatt-hour, one thousand kilowatt-hours.

**NDT** - nuclear plant decommissioning trust.

**NERC** - North American Electric Reliability Corporation.

**NorthWestern** - NorthWestern Corporation, a Delaware corporation, and successor in interest to Montana Power's electricity delivery business, including Montana Power's rights and obligations under contracts with PPL Montana.

**NPDES** - National Pollutant Discharge Elimination System.

**NPNS** - the normal purchases and normal sales exception as permitted by derivative accounting rules.

**NRC** - Nuclear Regulatory Commission, the federal agency that regulates nuclear power facilities.

**JUGs** (Non-Utility Generators) - generating plants not owned by public utilities, whose electrical output must be purchased by utilities under the PURPA if the plant meets certain criteria.

**NYMEX** - New York Mercantile Exchange.

**OCI** - other comprehensive income or loss.

**Ofgem** - Office of Gas and Electricity Markets, the British agency that regulates transmission, distribution and wholesale sales of electricity and related matters.

**PEDFA** - Pennsylvania Economic Development Financing Authority.

**PJM** (PJM Interconnection, L.L.C.) - operator of the electric transmission network and electric energy market in all or parts of Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and the District of Columbia.

**PLR** (Provider of Last Resort) - the role of PPL Electric in providing default electricity supply to retail customers within its delivery territory who have not chosen to select an alternative electricity supplier under the Customer Choice Act.

**PP&E** - property, plant and equipment.

**PUC** - Pennsylvania Public Utility Commission, the state agency that regulates certain ratemaking, services, accounting and operations of Pennsylvania utilities.

**PUC Final Order** - final order issued by the PUC on August 27, 1998, approving the settlement of PPL Electric's restructuring proceeding.

**PUHCA** - Public Utility Holding Company Act of 1935, legislation passed by the U.S. Congress. Repealed effective February 2006 by the Energy Policy Act of 2005.

**URPA** - Public Utility Regulatory Policies Act of 1978, legislation passed by the U.S. Congress to encourage energy conservation, efficient use of resources and equitable rates.

**PURTA** - The Pennsylvania Public Utility Realty Tax Act.

**RAB** - regulatory asset base. This term is also commonly known as RAV.

**RECs** - renewable energy credits.

**Regulation S-K** - SEC regulation governing the content of reports and other documents required to be filed pursuant to the federal securities laws.

**RFC** - ReliabilityFirst Corporation (the regional reliability entity that replaced the Mid-Atlantic Area Coordination Council).

**RMC** - Risk Management Committee.

**RMR** - reliability must run. Describes a generation facility that is operated at the request of an ISO to ensure system reliability, generally in a transmission constrained area of the electricity system.

**RTO** - Regional Transmission Organization.

**Sarbanes-Oxley** - Sarbanes-Oxley Act of 2002, which sets requirements for management's assessment of internal controls for financial reporting. It also requires an independent auditor to make its own assessment.

**SCR** - selective catalytic reduction, a pollution control process .

**Scrubber** - an air pollution control device that can remove particulates and/or gases (such as sulfur dioxide) from exhaust gases.

**SEC** - Securities and Exchange Commission, a U.S. government agency whose primary mission is to protect investors and maintain the integrity of the securities markets.

**S&P** - Standard & Poor's Ratings Services.

**Smart meter** - an electric meter that utilizes smart metering technology.

**Smart metering technology** - technology that can measure, among other things, time of electricity consumption to permit offering rate incentives for usage during lower cost or demand intervals.

**Superfund** - federal environmental legislation that addresses remediation of contaminated sites; states also have similar statutes.

**Synfuel projects** - production facilities that manufactured synthetic fuel from coal or coal byproducts. Favorable federal tax credits, which expired effective December 31, 2007, were available on qualified synthetic fuel products.

**Tolling agreement** - agreement whereby the owner of an electric generating facility agrees to use that facility to convert fuel provided by a third party into electric energy for delivery back to the third party.

**Total shareowner return** - increase in market value of a share of the Company's common stock plus the value of all dividends paid on a share of the common stock during the applicable performance period, divided by the price of the common stock as of the beginning of the performance period.

**VaR** - value-at-risk, a statistical model that attempts to estimate the value of potential loss over a given holding period under normal market conditions at a given confidence level.

**VEBA** - Voluntary Employee Benefit Association Trust, trust accounts for health and welfare plans for future benefit payments for employees, retirees or their beneficiaries.

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## FORWARD-LOOKING INFORMATION

Statements contained in this Form 10-K concerning expectations, beliefs, plans, objectives, goals, strategies, future events or performance and underlying assumptions and other statements which are other than statements of historical fact are "forward-looking statements" within the meaning of the federal securities laws. Although PPL, PPL Energy Supply and PPL Electric believe that the expectations and assumptions reflected in these statements are reasonable, there can be no assurance that these expectations will prove to be correct. Forward-looking statements are subject to many risks and uncertainties, and actual results may differ materially from the results discussed in forward-looking statements. In addition to the specific factors discussed in "Item 1A. Risk Factors" and in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in this Form 10-K report, the following are among the important factors that could cause actual results to differ materially from the forward-looking statements.

- fuel supply cost and availability;
- weather conditions affecting generation, customer energy use and operating costs;
- operation, availability and operating costs of existing generation facilities;
- transmission and distribution system conditions and operating costs;
- potential expansion of alternative sources of electricity generation;
- potential laws or regulations to reduce emissions of "greenhouse" gases;
- collective labor bargaining negotiations;
- the outcome of litigation against PPL and its subsidiaries;
- potential effects of threatened or actual terrorism, war or other hostilities, or natural disasters;
- the commitments and liabilities of PPL and its subsidiaries;
- market demand and prices for energy, capacity, emission allowances and delivered fuel;
- competition in retail and wholesale power markets;
- liquidity of wholesale power markets;
- defaults by counterparties under energy, fuel or other power product contracts;
- market prices of commodity inputs for ongoing capital expenditures;
- capital market conditions, including the availability of capital or credit, changes in interest rates, and decisions regarding capital structure;
- stock price performance of PPL;
- the fair value of debt and equity securities and the impact on defined benefit costs and resultant cash funding requirements for defined benefit plans;
- interest rates and their effect on pension, retiree medical and nuclear decommissioning liabilities;
- the impact of the current financial and economic downturn;
- the effect of electricity price deregulation beginning in 2010 in PPL Electric's service territory;
- the profitability and liquidity, including access to capital markets and credit facilities, of PPL and its subsidiaries;
- new accounting requirements or new interpretations or applications of existing requirements;
- changes in securities and credit ratings;
- foreign currency exchange rates;
- current and future environmental conditions, regulations and other requirements and the related costs of compliance, including environmental capital expenditures, emission allowance costs and other expenses;
- political, regulatory or economic conditions in states, regions or countries where PPL or its subsidiaries conduct business;
- receipt of necessary governmental permits, approvals and rate relief;
- new state, federal or foreign legislation, including new tax legislation;
- state, federal and foreign regulatory developments;
- the outcome of any rate cases by PPL Electric at the PUC;
- the impact of any state, federal or foreign investigations applicable to PPL and its subsidiaries and the energy industry;
- the effect of any business or industry restructuring;
- development of new projects, markets and technologies;
- performance of new ventures; and
- business or asset acquisitions and dispositions.

Any such forward-looking statements should be considered in light of such important factors and in conjunction with other documents of PPL, PPL Energy Supply and PPL Electric on file with the SEC.

New factors that could cause actual results to differ materially from those described in forward-looking statements emerge from time to time, and it is not possible for PPL, PPL Energy Supply or PPL Electric to predict all such factors, or the extent to which any such factor or combination of factors may cause actual results to differ from those contained in any forward-looking statement. Any forward-looking statement speaks only as of the date on which such statement is made, and PPL, PPL Energy Supply and PPL Electric undertake no obligation to update the information contained in such statement to reflect subsequent developments or information.

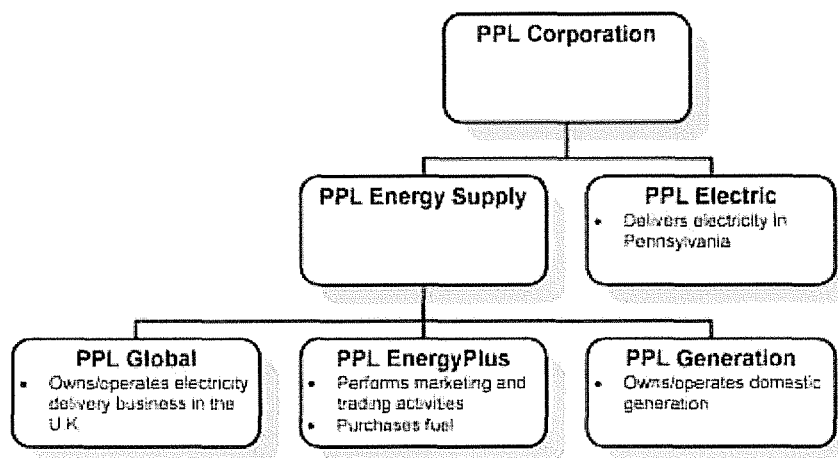
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## PART I

### ITEM 1. BUSINESS

#### **BACKGROUND**

*PPL Corporation*, headquartered in Allentown, PA, is an energy and utility holding company that was incorporated in 1994. Through its subsidiaries, PPL generates electricity from power plants in the northeastern and western U.S., markets wholesale or retail energy primarily in the northeastern and western portions of the U.S. and delivers electricity to approximately 4 million customers in Pennsylvania and the U.K. PPL's significant subsidiaries are shown below:



In addition to PPL Corporation, the other SEC registrants included in this filing are:

*PPL Energy Supply, LLC*, an indirect wholly owned subsidiary of PPL formed in 2000, is an energy company engaged through its subsidiaries in the generation and marketing of power, primarily in the northeastern and western power markets of the U.S. and in the delivery of electricity in the U.K. PPL Energy Supply's major operating subsidiaries are PPL Generation, PPL EnergyPlus and PPL Global. At December 31, 2009, PPL Energy Supply owned or controlled 11,719 MW of electric power generation capacity and has plans to implement capital projects at certain of its existing generation facilities in Pennsylvania and Montana to provide 239 MW of additional generating capacity by 2014.

*PPL Electric Utilities Corporation*, incorporated in 1920, is a direct subsidiary of PPL and a regulated public utility. PPL Electric provides electricity delivery service in its service territory in Pennsylvania and provides electricity supply to retail customers in that territory as a PLR under the Customer Choice Act.

#### Segment Information

PPL is organized into three segments: Supply, Pennsylvania Delivery and International Delivery. PPL Energy Supply's segments consist of Supply and International Delivery. PPL Electric operates in a single business segment. See Note 2 to the Financial Statements for financial information about the segments and geographic financial data.

#### • Supply Segment -

*Owns and operates domestic power plants to generate electricity; markets and trades this electricity and other purchased power to deregulated wholesale and retail markets; and acquires and develops domestic generation projects. Consists primarily of the activities of PPL Generation and PPL EnergyPlus.*

PPL Energy Supply has generation assets that are located in the eastern and western U.S. markets. The eastern generation assets are located in the Northeast/Mid-Atlantic energy markets - including PJM, the New York ISO and ISO New England. PPL Energy Supply's western generating capacity is located in markets within the Western Electricity Coordinating Council.

#### PPL Energy Supply Owned or Controlled Generation Capacity

PPL Energy Supply owned or controlled generating capacity of 11,719 MW at December 31, 2009. Through subsidiaries, PPL Generation owns and operates power plants primarily in Pennsylvania, Montana, Illinois, Connecticut, New York and Maine. The total owned or controlled generating capacity includes power obtained through PPL EnergyPlus' tolling or power purchase agreements (including Ironwood and other facilities that consist of NUGs, wind farms and landfill gas facilities). See "Item 2. Properties - Supply Segment" for a complete listing of PPL Energy Supply's generating capacity.

PPL Energy Supply's U.S. generation subsidiaries are EWGs, which sell electricity into the wholesale market. PPL Energy Supply's EWGs are subject to regulation by the FERC, which has authorized these EWGs to sell generation from their facilities at market-based prices. The electricity from these plants is sold to PPL EnergyPlus under FERC-jurisdictional power purchase agreements.



PPL Generation operates its Pennsylvania and Illinois power plants in conjunction with PJM. PPL Generation's Pennsylvania and Illinois power plants and PPL EnergyPlus are members of the RFC. Refer to "Pennsylvania Delivery Segment" for information regarding PJM's operations and functions and the RFC.

Pennsylvania generation had a total capacity of 9,583 MW at December 31, 2009. These plants are fueled by uranium, coal, natural gas, oil, water and other fuels.

PPL Susquehanna, a subsidiary of PPL Generation, owns a 90% undivided interest in each of the two nuclear-fueled generating units at its Susquehanna station in Pennsylvania. Allegheny Electric Cooperative, Inc. owns the remaining 10% undivided interest. PPL's 90% share of Susquehanna's generating capacity was 2,206 MW at December 31, 2009. The Illinois natural gas-fired station has a total capacity of 585 MW.

The Montana coal-fired and hydroelectric-powered stations have a capacity of 1,286 MW. PPL Montana's power plants are operated in conjunction with the Western Electricity Coordinating Council.

The Connecticut natural gas-fired station has a total capacity of 244 MW, is operated in conjunction with ISO New England and the Northeast Power Coordinating Council.

The New York oil/gas-fired stations have a capacity of 159 MW. These generating assets are operated in conjunction with the New York ISO and the Northeast Power Coordinating Council. Tolling agreements are in place for 100% of the capacity and output of this business. See Note 9 to the Financial Statements for additional information on the anticipated sale of the Long Island generation business.

The Maine hydroelectric-powered stations have a total capacity of 12 MW. The Maine generating assets are operated in conjunction with ISO New England and the Northeast Power Coordinating Council. See Note 9 to the Financial Statements for information on the November 2009 sale of the majority of the Maine hydroelectric business, the sale of PPL's interest in an oil-fired unit in Maine and the conditional agreement of sale for the remaining three hydroelectric facilities.

PPL Generation has current plans for capital projects at certain of its generation facilities in Pennsylvania and Montana to provide 239 MW of additional generation capacity for its use by 2014. See "Item 2. Properties - Supply Segment" for additional information regarding these capital projects.

Refer to the "Power Supply" section for additional information regarding electricity generated by the power plants operated by PPL Generation and to the "Fuel Supply" section for a discussion of fuel requirements and contractual arrangements for fuel.

A subsidiary of PPL Energy Supply develops renewable energy plants on various sites using technologies such as turbines, reciprocating engines and photovoltaic solar panels. Included in PPL Energy Supply's owned or controlled generating capacity reported in "Item 2. Properties - Supply Segment" is approximately 28 MW of installed capacity from these projects that serve commercial and industrial customers.

Certain PPL Energy Supply subsidiaries are subject to the jurisdiction of certain federal, regional, state and local regulatory agencies with respect to air and water quality, land use and other environmental matters. PPL Susquehanna is subject to the jurisdiction of the NRC in connection with the operation of the Susquehanna units. Certain of PPL Energy Supply's other subsidiaries are subject to the jurisdiction of the NRC in connection with the operation of their fossil plants with respect to certain level and density monitoring devices.

Certain operations of PPL Generation's subsidiaries are subject to the Occupational Safety and Health Act of 1970 and comparable state statutes.

### Energy Marketing

PPL EnergyPlus sells the electricity produced by PPL Generation subsidiaries, along with purchased power, FTRs, natural gas, oil, uranium, emission allowances and RECs in competitive wholesale and deregulated retail markets in order to take advantage of opportunities in the competitive energy marketplace.

PPL EnergyPlus purchases and sells electric capacity and energy at the wholesale level at competitive prices under FERC market-based prices. PPL EnergyPlus enters into these agreements to market available energy and capacity from PPL Generation's assets and to profit from market price fluctuations. Within the constraints of its hedging policy, PPL EnergyPlus actively manages its portfolios to optimize the value of PPL's generating assets and to limit exposure to price fluctuations. PPL EnergyPlus also enters into over-the-counter and futures contracts to purchase and sell energy and other commodity-based financial instruments in accordance with PPL's risk management policies, objectives and strategies.

PPL EnergyPlus had contracted to provide electricity to PPL Electric sufficient for it to meet its PLR obligation through 2009 at the predetermined capped rates PPL Electric was entitled to charge its customers. These contracts accounted for 29% of PPL Energy Supply's operating revenues in 2009 and expired December 31, 2009. See Note 15 to the Financial Statements for more information concerning these contracts.

PPL EnergyPlus is licensed to provide retail electric supply to customers in Delaware, Maine, Massachusetts, Maryland, Montana, New Jersey and Pennsylvania and provides electricity to industrial and commercial customers in Montana and Pennsylvania. PPL EnergyPlus provides natural gas to customers in Pennsylvania, New Jersey, Delaware and Maryland.

### Competition

The unregulated businesses and markets in which PPL and its subsidiaries participate are highly competitive. Since the early 1990s, there has been increased competition in U.S. energy markets because of federal and state deregulation initiatives. For example, in 1992 the Energy Act amended the Federal Power Act to provide open access to electric transmission systems for wholesale transactions. In 1996, the Customer Choice Act was enacted in Pennsylvania to restructure the state's electric utility industry to create a competitive market for electricity generation. Certain other states in which PPL's subsidiaries operate have also adopted "customer choice" plans to allow customers to choose their electricity supplier. PPL and its subsidiaries believe that competition in deregulated energy markets will continue to be intense.

The Supply segment faces competition in wholesale markets for available energy, capacity and ancillary services. Competition is impacted by electricity and fuel prices, new market entrants, construction by others of generating assets, technological advances in power generation, the actions of environmental and other regulatory authorities and other factors. The Supply segment primarily competes with other electricity suppliers based on its ability to aggregate generation supply at competitive prices from different sources and to efficiently utilize transportation from third-party pipelines and transmission from electric utilities and ISOs. Competitors in wholesale power markets include regulated utilities, industrial companies, non-utility generators, unregulated subsidiaries of regulated utilities and other energy marketers. See "Item 1A. Risk Factors - Risks Related to Supply Segment" and PPL's and PPL Energy Supply's "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Overview" for more information concerning the risks faced with respect to competition in deregulated energy markets.

### Power Supply

PPL Energy Supply's owned or controlled system capacity (winter rating) at December 31, 2009 was 11,719 MW. The capacity of generating units is based upon a number of factors, including the operating experience and physical condition of the units, and may be revised periodically to reflect changes in circumstances. See "Item 2. Properties - Supply Segment" for a description of PPL Energy Supply's plants at December 31, 2009.

During 2009, PPL Energy Supply's plants, excluding renewable facilities that are discussed separately below, generated the following amounts of electricity.

<u>State</u>	<u>Millions of kWh</u>
Pennsylvania	46,019
Montana	8,120
Maine	261
Connecticut	108
New York (a)	
Illinois	64
Total	<u>54,572</u>

(a) 72 million kWhs were excluded as tolling agreements were in place for 100% of the output.

Of this generation, 49% of the energy was from coal-fired stations, 32% from nuclear operations at the Susquehanna station, 11% from oil/gas-fired stations and 8% from hydroelectric stations.

PPL Energy Supply estimates that, on average, approximately 94% of its total expected annual generation output for 2010 will be used to meet EnergyPlus' committed contractual sales. PPL Energy Supply has also entered into commitments of varying quantities and terms for the years 2011 and beyond. These commitments are consistent with, and integral to, PPL Energy Supply's business strategy to capture profits while managing exposure to adverse movements in energy and fuel prices. See "Commodity Volumetric Activity" in Note 18 to the Financial Statements for the strategies PPL Energy Supply employs to optimize the value of its wholesale and retail energy portfolio.

Subsidiaries of PPL Energy Supply controlled existing renewable energy projects located in Pennsylvania, New Jersey, Vermont and New Hampshire with capacity of 28 MW. PPL EnergyPlus sells the energy and RECs produced by these plants to commercial, industrial and institutional customers. During 2009, these projects generated 145 million kWhs. In addition, a PPL Energy Supply subsidiary owns renewable energy facilities with capacity of 6 MW that have power purchase agreements in place. During 2009, these projects generated 23 million kWhs.

PPL EnergyPlus also purchases the full output from two wind farms in Pennsylvania with a combined capacity of 50 MW.

### Fuel Supply

#### Coal

##### Pennsylvania

PPL Generation, by and through its agent PPL EnergyPlus, actively manages PPL's coal requirements by purchasing coal principally from mines located in central and northern Appalachia.

During 2009, PPL Generation, by and through its agent PPL EnergyPlus, purchased 100% of the coal delivered to PPL Generation's wholly owned Pennsylvania stations under short-term and long-term contracts. These contracts provided PPL Generation 7.3 million tons of coal. Contracts currently in place are expected to provide 7.8 million tons in 2010. The amount of coal in inventory varies from time to time depending on market conditions and plant operations.

PPL Generation, by and through its agent PPL EnergyPlus, entered into a long-term coal purchase agreement with CONSOL Energy Inc. The contract will provide more than one-third of PPL Generation's projected annual coal needs for the Pennsylvania power plants from 2010 through 2018. PPL Generation has other contracts that, in total, will provide additional coal supply for PPL's projected annual needs from 2010 through 2013.

A PPL Generation subsidiary owns a 12.34% interest in the Keystone station and a 16.25% interest in the Conemaugh station. The Keystone station contracts with Keystone Fuels, LLC for its coal requirements. In 2009, Keystone Fuels, LLC provided 4.8 million tons of coal to the Keystone station. The Conemaugh station requirements are purchased under contract from Conemaugh Fuels, LLC. In 2009, Conemaugh Fuels, LLC provided 4.8 million tons of coal to the Conemaugh station. A PPL Generation subsidiary also owns a 12.34% equity interest in Keystone Fuels, LLC and a 16.25% equity interest in Conemaugh Fuels, LLC.

Scrubbers were placed in service at Montour in 2008 and at Brunner Island in 2009. At December 31, 2009, scrubbers were in place at all of PPL Generation's Pennsylvania coal stations. Contracts are in place for all the limestone requirements for all the scrubbers at PPL Generation's wholly owned Pennsylvania coal stations through 2010. It is projected that annual limestone requirements will be approximately 600,000 tons. During 2009, approximately 325,000 tons of limestone were delivered to PPL Generation's wholly owned Pennsylvania stations under long-term contracts.

#### *Montana*

PPL Montana has a 50% leasehold interest in Colstrip Units 1 and 2, and a 30% leasehold interest in Colstrip Unit 3. NorthWestern owns a 30% leasehold interest in Colstrip Unit 4. PPL Montana and NorthWestern have a sharing agreement to govern each party's responsibilities regarding the operation of Colstrip Units 3 and 4, and each party is responsible for 15% of the respective operating and construction costs, regardless of whether a particular cost is specified to Colstrip Unit 3 or 4. However, each party is responsible for its own fuel-related costs. PPL Montana, along with the other owners, is party to contracts to purchase 100% of its coal requirements with defined coal quality characteristics and specifications. In 2007, PPL Montana entered into a long-term purchase and supply agreement with the current supplier for Units 1 and 2 beginning January 1, 2010. The contract is to provide these units 100% of their coal requirements through December 2014, and at least 85% of such requirements from January 2015 through December 2019. The coal supply contract for Unit 3's requirements is in effect through December 2019. Scrubbers are in place at all of these units.

Coal supply contracts are in place to purchase low-sulfur coal with defined quality characteristics and specifications for PPL Montana's Corette station. The contracts covered 100% of the station's coal requirements in 2009, and similar contracts are currently in place to supply 100% of the expected coal requirements through 2012.

#### Oil and Natural Gas

##### *Pennsylvania*

PPL Generation's Martins Creek Units 3 and 4 burn both oil and natural gas. PPL EnergyPlus is responsible for procuring the oil and natural gas supply for all PPL Generation operations. During 2009, 100% of the physical gas and oil requirements for the Martins Creek units were purchased on the spot market. At December 31, 2009, PPL EnergyPlus had no long-term agreements for oil or gas.

PPL EnergyPlus has a short-term and long-term gas transportation contract in place for approximately 30% of the maximum daily requirements of the Lower Mt. Bethel facility.

In 2008, PPL EnergyPlus acquired the rights to an existing long-term tolling agreement associated with the capacity and energy of the Ironwood facility. PPL EnergyPlus has long-term transportation contracts to serve approximately 25% of Ironwood's maximum daily requirements, which begins in the fourth quarter of 2010. For the first three quarters of 2010, Ironwood will be served through a combination of transportation capacity release transactions and delivered supply to the plant. PPL EnergyPlus currently has no long-term physical supply agreements to purchase natural gas for Ironwood.

##### *Illinois*

At December 31, 2009, there were no long-term delivery or supply agreements to purchase natural gas for the University Park facility.

##### *Connecticut*

PPL EnergyPlus has a long-term contract for approximately 40% of the expected pipeline transportation requirements of the Wallingford facility, but has no long-term physical supply agreement to purchase natural gas.

#### Nuclear

The nuclear fuel cycle consists of several material and service components: the mining and milling of uranium ore to produce uranium

concentrates; the conversion of these concentrates into uranium hexafluoride, a gas component; the enrichment of the hexafluoride gas; the fabrication of fuel assemblies for insertion and use in the reactor core; and the temporary storage and final disposal of spent nuclear fuel.

PPL Susquehanna has a portfolio of supply contracts, with varying expiration dates, for nuclear fuel materials and services. These contracts are expected to provide sufficient fuel to permit Unit 1 to operate into the first quarter of 2016 and Unit 2 to operate into the first quarter of 2015. PPL Susquehanna anticipates entering into additional contracts to ensure continued operation of the nuclear units.

Federal law requires the federal government to provide for the permanent disposal of commercial spent nuclear fuel. Under the Federal Nuclear Waste Policy Act, the DOE carried out an analysis of a site in Nevada for a permanent nuclear waste repository. There is no definitive date by which a repository will be operational. As a result, it was necessary to expand Susquehanna's on-site spent fuel storage capacity. To support this expansion, PPL Susquehanna contracted for the design and construction of a spent fuel storage facility employing dry cask fuel storage technology. The facility is modular, so that additional storage capacity can be added as needed. The facility began receiving spent nuclear fuel in 1999. PPL Susquehanna estimates that there is sufficient storage capacity in the spent nuclear fuel pools and the on-site spent fuel storage facility at Susquehanna to accommodate spent fuel discharged through approximately 2017 under current operating conditions. If necessary, the on-site spent fuel storage facility can be expanded, assuming appropriate regulatory approvals are obtained. If additional on-site storage capacity is required, supplementary storage capacity will be pursued.

#### Franchise and Licenses

See "Background - Segment Information - Supply Segment - Energy Marketing" for a discussion of PPL EnergyPlus' licenses in various states. PPL EnergyPlus also has an export license from the DOE to sell capacity and/or energy to electric utilities in Canada.

PPL Susquehanna operates Units 1 and 2 pursuant to NRC operating licenses. In November 2009, the NRC approved PPL Susquehanna's application for 20-year license renewals for each of the Susquehanna units, extending the license expiration dates to 2042 for Unit 1 and to 2044 for Unit 2. See Note 8 to the Financial Statements for additional information.

In 2008, PPL Susquehanna received NRC approval for its request to increase the generation capacity of the Susquehanna nuclear plant. The total expected capacity increase is 159 MW, of which PPL Susquehanna's 90% ownership share would be 143 MW. The first uprate for Unit 1 totaling 50 MW was completed in 2008 and the second uprate is scheduled to be completed in 2010. The first uprate for Unit 2 totaling 50 MW was completed in 2009, and the second uprate is scheduled to be completed in 2011. The remaining total capacity increase is 59 MW, of which PPL Susquehanna's share is 53 MW. PPL Susquehanna's share of the expected capital cost for the total uprate of 143 MW is \$345 million.

In October 2008, a PPL subsidiary submitted a COLA to the NRC for a new nuclear generating unit (Bell Bend) to be built adjacent to the Susquehanna plant. The COLA was accepted for review by the NRC in December 2008. In May 2009, the NRC published its official review schedule that culminates with the issuance of Bell Bend's final safety evaluation report in 2012. See Note 8 to Financial Statements for additional information.

PPL Holtwood operates the Holtwood hydroelectric generating station pursuant to a license that was recently extended by the FERC to expire in 2030. PPL Holtwood operates the Wallenpaupack hydroelectric generating station pursuant to a license renewed by the FERC in 2005 and expiring in 2044. PPL Holtwood also owns one-third of the capital stock of Safe Harbor Water Power Corporation (Safe Harbor), which holds a project license that extends the operation of its hydroelectric generating station until 2030. The total capacity of the Safe Harbor generating station is 421 MW, and PPL Holtwood is entitled by contract to one-third of the total capacity.

In 2007, PPL requested FERC approval to expand its Holtwood plant by 125 MW. In 2008, PPL withdrew the application in light of prevailing economic conditions, including the high cost of capital and projections of future energy prices. PPL reconsidered its Holtwood expansion project in view of the tax incentives and potential loan guarantees for renewable energy projects contained in the Economic Stimulus Package. In April 2009, PPL resubmitted the expansion application to FERC and in October 2009, the FERC approved the request to expand the plant and extended the operating license through August 2030. See Note 8 to the Financial Statements for additional information.

The 11 hydroelectric facilities and one storage reservoir in Montana are licensed by the FERC. These licenses expire periodically and the generating facilities must be relicensed at such times. The FERC license for the Mystic facility expired in 2009 but has been extended, effective January 1, 2010, for an additional 40-year term. The Thompson Falls and Kerr licenses expire in 2025 and 2035, respectively; and the licenses for the nine Missouri-Madison facilities expire in 2040.

In connection with the relicensing of these generation facilities, the FERC may, under applicable law, relicense the original licensee or license a new licensee, or the U.S. government may take over the facility. If the original licensee is not relicensed, it is compensated for its net investment in the facility, not to exceed the fair value of the property taken, plus reasonable damages to other property affected by the lack of relicensing.

- Pennsylvania Delivery Segment -

*Includes the regulated electric delivery operations of PPL Electric.*

#### PPL Electric

PPL Electric delivers electricity to approximately 1.4 million customers in a 10,000-square mile territory in 29 counties of eastern and central Pennsylvania. The largest cities in this territory are Allentown, Bethlehem, Harrisburg, Hazleton, Lancaster, Scranton, Wilkes-Barre and

Williamsport.

PPL Electric is the sole electricity distribution provider in its service territory, and also provides electricity supply in that territory as a PLR. As part of the PUC Final Order, PPL Electric agreed to supply this electricity at predetermined capped rates through 2009. PPL Electric entered into two contracts to purchase electricity from PPL EnergyPlus sufficient for PPL Electric to meet its PLR obligation through 2009 at the capped rates. As discussed below, PPL Electric's PLR obligation after 2009 is governed by the PUC pursuant to the Public Utility Code as amended by Act 129, PLR regulations and a policy statement regarding interpretation and implementation of those regulations. Both the regulations and the policy statement became effective in September 2007. The PUC has approved PPL Electric's procurement plans for 2010 and for the period from January 2011 through May 2013. Refer to Notes 14 and 15 to the Financial Statements for additional information.

During 2009, about 98% of PPL Electric's operating revenues were derived from regulated electricity delivery and supply as a PLR. The remaining 2009 operating revenues were from wholesale revenues, primarily the sale to PPL EnergyPlus of power purchased from NUGs. During 2009, about 46% of electricity delivery and PLR revenues were from residential customers, 37% from commercial customers, 16% from industrial customers and 1% from other customer classes.

PPL Electric's transmission facilities are operated as part of PJM, which operates the electric transmission network and electric energy market in the mid-Atlantic and Midwest regions of the U.S. Bulk electricity is transmitted to wholesale users throughout a geographic area including all or part of Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and the District of Columbia. As of January 1, 2006, PPL Electric became a member of the RFC. The purpose of the RFC is to preserve and enhance electric service reliability and security for the interconnected electric systems within its territory and to be a regional entity under the framework of the NERC. The RFC's key functions are the development of regional standards for reliable planning and operation of the bulk electric system and non-discriminatory compliance monitoring and enforcement of both NERC and regional standards.

PJM serves as a FERC-approved RTO in order to promote greater participation and competition in the region. An RTO, like an ISO, is a designation provided by the FERC to a FERC-approved independent entity that operates the transmission system and typically administers a competitive power market. PJM also administers regional markets for energy, capacity and ancillary services. A primary purpose of the RTO/ISO is to separate the operation of, and access to, the transmission grid from market participants that buy or sell electricity in the same markets. Electric utilities continue to own the transmission assets, but the RTO/ISO directs the control and operation of the transmission facilities. PPL Electric is entitled to fully recover from retail customers the charges that it pays to PJM for transmission-related services. PJM imposes these charges pursuant to its FERC-approved Open Access Transmission Tariff.

PPL Electric is subject to regulation as a public utility by the PUC, and certain of its activities are subject to the jurisdiction of the FERC under the Federal Power Act.

PPL Electric also is subject to the jurisdiction of certain federal, regional, state and local regulatory agencies with respect to land use and other environmental matters. Certain operations of PPL Electric are subject to the Occupational Safety and Health Act of 1970 and comparable state statutes.

In November 2004, Pennsylvania enacted the Alternative Energy Portfolio Standard (the AEPS), which requires electric distribution companies, such as PPL Electric, and retail electric suppliers serving retail load to ultimately provide 18% of the electricity sold to retail customers in Pennsylvania from alternative energy sources by 2020. Under this state law, alternative energy sources include hydro, wind, solar, waste coal, landfill methane and fuel cells. An electric distribution company will pay an alternative compliance payment of \$45 (or, in the case of solar, 200% of the average market value of solar credits) for each MWh that it is short of its required alternative energy supply percentage. PPL Electric became subject to the requirements of this legislation beginning in 2010. In 2010, PPL Electric is required to supply about 9% of the total amount of electricity it delivers to its PLR customers from alternative energy sources. PPL Electric has purchased all of the supply required to meet its 2010 default service obligations pursuant to a PUC-approved Competitive Bridge Plan (the Plan). Under the Plan, PPL Electric obtained full requirements service which includes the generation or credits that PPL Electric will need to comply with the AEPS in 2010.

Act 129 became effective in October 2008. The law creates an energy efficiency and conservation program and smart metering technology requirements, adopts new PLR electricity supply procurement rules, provides remedies for market misconduct, and makes changes to the existing AEPS.

See "Regulatory Issues - Pennsylvania Activities" in Note 14 to the Financial Statements for additional information regarding Act 129, other legislative and regulatory impacts and PPL Electric's actions to provide default electricity supply for periods after 2009.

### Competition

Pursuant to authorizations from the Commonwealth of Pennsylvania and the PUC, PPL Electric operates a regulated distribution monopoly in its service area. Accordingly, PPL Electric does not face competition in its electricity distribution business.

Effective January 1, 2010, PPL Electric's rates for generation supply as a PLR are no longer capped and the cost of electric generation is based on a competitive solicitation process. Prior to the expiration of the generation rate caps, PPL Electric's customers' interest in purchasing generation supply from other providers was limited because, in recent years, the long-term supply agreement between PPL Electric and PPL EnergyPlus provided a below-market cost of generation supply for these customers. As a result, a limited amount of "shopping" occurred. In 2010, several alternative suppliers have offered to provide generation supply in PPL Electric's service territory. When its customers purchase supply from these alternative suppliers or from PPL Electric as PLR, the purchase of such supply has no significant impact on the operating

results of PPL Electric. The cost to purchase PLR supply is passed directly by PPL Electric to its customers without markup. PPL Electric remains the distribution provider for all the customers in its service territory and charges a regulated rate for the service of delivering that electricity.

#### Provider of Last Resort Supply

The Customer Choice Act requires electric distribution companies, like PPL Electric, to act as a PLR of electricity supply and provides that electricity supply costs will be recovered by such companies pursuant to regulations established by the PUC. In May 2007, the PUC approved PPL Electric's plan to procure default electricity supply for 2010 - after its current supply agreements with PPL EnergyPlus expire - for retail customers who do not choose an alternative competitive supplier. Pursuant to this plan, PPL Electric completed six competitive supply solicitations and has contracted for all of the 2010 electricity supply it expects to need for residential, small commercial and small industrial customers. In October 2009, PPL Electric purchased supply for fixed-price default service to large commercial and large industrial customers who elect to take that service in 2010. In November 2009, PPL Electric purchased supply to provide hourly default service to large commercial and industrial customers in 2010. See "Energy Purchase Commitments" in Note 14 to the Financial Statements for additional information regarding PPL Electric's solicitations for 2010 and its actions to provide default electricity supply for periods after 2010.

#### Franchise and Licenses

PPL Electric is authorized to provide electric public utility service throughout its service area as a result of grants by the Commonwealth of Pennsylvania in corporate charters to PPL Electric and companies to which it has succeeded and as a result of certification by the PUC. PPL Electric is granted the right to enter the streets and highways by the Commonwealth subject to certain conditions. In general, such conditions have been met by ordinance, resolution, permit, acquiescence or other action by an appropriate local political subdivision or agency of the Commonwealth.

- **International Delivery Segment -**

*Includes WPD, a regulated electricity distribution company in the U.K.*

WPD, through indirect wholly owned subsidiaries, operates two of the 15 distribution networks providing electricity service in the U.K. The WPD subsidiaries together serve approximately 2.6 million end-users in the U.K. WPD (South West) serves 1.5 million customers in a 5,560 square mile area of southwest England. WPD (South Wales) serves an area of Wales opposite the Bristol Channel from WPD (South West)'s territory. Its 1.1 million customers occupy 4,550 square miles within Wales. WPD is headquartered in Bristol, England. See "Franchise and Licenses" for additional information about WPD's regulator, Ofgem, which sets price controls and grants distribution licenses.

#### Competition

Although WPD operates in non-exclusive concession areas in the U.K., it currently faces little competition with respect to residential customers. See "Franchises and Licenses" for more information.

#### Franchise and Licenses

WPD is authorized by the U.K. government to provide electric distribution services within its concession areas and service territories, subject to certain conditions and obligations. For instance, WPD is subject to governmental regulation of the prices it can charge and the quality of service it must provide, and WPD can be fined or have its licenses revoked if it does not meet the mandated standard of service.

WPD operates under distribution licenses granted, and price controls set, by Ofgem. The price control formula that governs WPD's allowed revenue is normally determined every five years. Ofgem completed a rate review in December 2009 for the five-year period from April 1, 2010 through March 31, 2015. See PPL's and PPL Energy Supply's "Results of Operations - Segment Results - International Delivery Segment" in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" for additional information.

### **SEASONALITY**

Demand for and market prices of electricity are affected by weather. As a result, PPL's overall operating results in the future may fluctuate substantially on a seasonal basis, especially when more severe weather conditions such as heat waves or winter storms make such fluctuations more pronounced. The pattern of this fluctuation may change depending on the type and location of the facilities PPL owns and the terms of its contracts to purchase or sell electricity.

### **FINANCIAL CONDITION**

See PPL's, PPL Energy Supply's and PPL Electric's "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" for this information.

### **CAPITAL EXPENDITURE REQUIREMENTS**

See "Financial Condition - Liquidity and Capital Resources - Forecasted Uses of Cash - Capital Expenditures" in PPL's, PPL Energy Supply's and PPL Electric's "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" for information concerning projected capital expenditure requirements for the years 2010-2012. See Note 14 to the Financial Statements for additional information concerning the potential impact on capital expenditures from environmental matters.

## ENVIRONMENTAL MATTERS

PPL and certain PPL subsidiaries, including PPL Electric and PPL Generation subsidiaries, are subject to certain existing and developing federal, regional, state and local laws and regulations with respect to air and water quality, land use and other environmental matters. See PPL's and PPL Energy Supply's "Financial Condition - Liquidity and Capital Resources" in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Forecasted Uses of Cash - Capital Expenditures" for information concerning environmental capital expenditures during 2009 and projected environmental capital expenditures for the years 2010-2012. See "Environmental Matters" in Note 14 to the Financial Statements for information regarding these laws and regulations and the status of PPL's and its subsidiaries' compliance and remediation activities, as well as legal and regulatory proceedings involving PPL and its subsidiaries.

PPL and its subsidiaries are unable to predict the ultimate effect of evolving environmental laws and regulations upon their existing and proposed facilities and operations and competitive positions. In complying with statutes, regulations and actions by regulatory bodies involving environmental matters, including, among other things, air and water quality, greenhouse gas emissions, hazardous and solid waste management and disposal, and regulation of toxic substances, PPL's subsidiaries may be required to modify, replace or cease operating certain of their facilities. PPL's subsidiaries may also incur significant capital expenditures and operating expenses in amounts which are not now determinable, but could be significant.

## EMPLOYEE RELATIONS

As of December 31, 2009, PPL and its subsidiaries had the following full-time employees.

PPL Energy Supply	
PPL Generation	2,665
PPL EnergyPlus	2,020 (a)
PPL Global (primarily WPD)	2,369
Total PPL Energy Supply	<u>7,054</u>
PPL Electric	2,166
PPL Services and other	1,269
Total PPL	<u><u>10,489</u></u>

(a) Includes union employees of mechanical contracting subsidiaries, whose numbers tend to fluctuate due to the nature of this business.

Approximately 4,980, or 61%, of PPL's domestic workforce are members of labor unions, with three IBEW locals representing approximately 3,540 employees. Other unions primarily represent employees of the mechanical contractors. The bargaining agreement with the largest IBEW local was negotiated in May 2006 and expires in May 2010. This agreement covers approximately 3,200 employees. The IBEW, representing approximately 260 employees at the Montana Colstrip power plants, is covered under a four-year labor agreement expiring in April 2012. In January 2008, a four-year contract that expires in April 2012 was renegotiated with the IBEW local of Montana that represents approximately 80 employees at the hydroelectric facilities and at the Corette plant.

Approximately 1,860, or 79%, of PPL's U.K. workforce are members of labor unions. WPD recognizes five unions, the largest of which represents 37% of its union workforce. WPD's Electricity Business Agreement covers approximately 1,810 union employees; it may be amended by agreement between WPD and the unions and is terminable with 12 months notice by either side.

See "Separation Benefits" in Note 12 to the Financial Statements for information on a 2009 cost reduction initiative, which resulted in the elimination of approximately 200 domestic management and staff positions at PPL.

## AVAILABLE INFORMATION

PPL's Internet Web site is [www.pplweb.com](http://www.pplweb.com). On the Investor Center page of that Web site, PPL provides access to all SEC filings of PPL, PPL Energy Supply and PPL Electric free of charge, as soon as reasonably practicable after filing with the SEC. Additionally, PPL registrants' filings are available at the SEC's Web site ([www.sec.gov](http://www.sec.gov)) and at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549, or by calling 1-800-SEC-0330.

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## **ITEM 1A. RISK FACTORS**

PPL, PPL Energy Supply and PPL Electric face various risks associated with their businesses. While we have identified below the risks we currently consider material, these risks are not the only risks that we face. Additional risks not presently known to us or that we currently deem immaterial may also impair our business operations. Our businesses, financial condition, cash flows or results of operations could be materially adversely affected by any of these risks. In addition, this report also contains forward-looking and other statements about our businesses that are subject to numerous risks and uncertainties. See "Forward-Looking Information," "Item 1. Business," "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and Note 14 to the Financial Statements for more information concerning the risks described below and for other risks, uncertainties and factors that could impact our businesses and financial results.

As used in this Item 1A., the terms "we," "our" and "us" generally refer to PPL and its consolidated subsidiaries taken as a whole, or to PPL Energy Supply and its consolidated subsidiaries taken as a whole within the Supply and International Delivery segment discussions, or PPL Electric and its consolidated subsidiaries taken as a whole within the Pennsylvania Delivery segment discussion.

### **Risks Related to Supply Segment**

( PPL and PPL Energy Supply )

*We are exposed to operational, price and credit risks associated with selling and marketing products in the wholesale electricity markets.*

We purchase and sell electricity in wholesale markets under market-based tariffs authorized by the FERC throughout the U.S. and also enter into short-term agreements to market available electricity and capacity from our generation assets with the expectation of profiting from market price fluctuations. If we are unable to deliver firm capacity and electricity under these agreements, we could be required to pay damages. These damages would generally be based on the difference between the market price to acquire replacement capacity or electricity and the contract price of any undelivered capacity or electricity. Depending on price volatility in the wholesale electricity markets, such damages could be significant. Extreme weather conditions, unplanned generation facility outages, environmental compliance costs, transmission disruptions, and other factors could affect our ability to meet our obligations, or cause significant increases in the market price of replacement capacity and electricity.

Our power agreements typically include provisions requiring us to post collateral for the benefit of our counterparties if the market price of energy varies from the contract prices in excess of certain pre-determined amounts. At December 31, 2009, we had posted \$242 million of collateral, in the form of letters of credit, under these contracts. At December 31, 2009, we maintained \$4.1 billion of liquidity facilities to provide for potential additional collateral obligations. We currently believe that we have sufficient credit to fulfill our potential collateral obligations under these power contracts. Our obligation to post collateral could exceed the amount of our facilities or our ability to increase our facilities could be limited by financial market or other factors.

We also face credit risk that parties with whom we contract will default in their performance, in which case we may have to sell our electricity into a lower-priced market or make purchases in a higher-priced market than existed at the time of contract. Whenever feasible, we attempt to mitigate these risks by various means, including agreements that require our counterparties to post collateral for our benefit if the market price of energy varies from the contract price in excess of certain pre-determined amounts. However, there can be no assurance that we will avoid counterparty nonperformance, which could adversely impact our ability to perform our obligations to other parties, which could in turn subject us to claims for damages.

*Adverse changes in commodity prices and related costs may decrease our future energy margins, which could adversely affect our earnings and cash flows.*

Our energy margins, or the amount by which our revenues from the sale of power exceed our costs to supply power, are impacted by changes in market prices for electricity, fuel, fuel transportation, emission allowances, RECs, electricity transmission and related congestion charges and other costs. Unlike most commodities, the limited ability to store electric power requires that it must be consumed at the time of production. As a result, wholesale market prices for electricity may fluctuate substantially over relatively short periods of time and can be unpredictable. Among the factors that influence such prices are:

- demand for electricity and supplies of electricity available from current or new generation resources;
- variable production costs, primarily fuel (and the associated fuel transportation costs) and emission allowance expense for the generation resources used to meet the demand for electricity;
- transmission capacity and service into, or out of, markets served;
- changes in the regulatory framework for wholesale power markets;
- liquidity in the wholesale electricity market, as well as general credit worthiness of key participants in the market; and
- weather and economic conditions impacting demand for electricity or the facilities necessary to deliver electricity.

See Exhibit 99(a) for more information concerning the market fluctuations in wholesale energy, fuel and emission allowance prices over the past five years. The volatility of these business factors has increased significantly with the current economic downturn.

*Our risk management policy and programs relating to electricity and fuel prices, interest rates, foreign currency and counterparties may not work as planned, and we may suffer economic losses despite such programs.*



We actively manage the market risk inherent in our generation energy marketing activities, as well as our debt, foreign currency and counterparty credit positions. We have implemented procedures to monitor compliance with our risk management policy and programs, including independent validation of transaction and market prices, verification of risk and transaction limits, portfolio stress test, sensitivity analyses and daily portfolio reporting of various risk management metrics. Nonetheless, our risk management programs may not work as planned. For example, actual electricity and fuel prices may be significantly different or more volatile than the historical trends and assumptions upon which we based our risk management calculations. Additionally, unforeseen market disruptions could decrease market depth and liquidity, negatively impacting our ability to enter into new transactions. We enter into financial contracts to hedge commodity basis risk, and as a result are exposed to the risk that the correlation between delivery points could change with actual physical delivery. Similarly, interest rates or foreign currency exchange rates could change in significant ways that our risk management procedures were not designed to address. As a result, we cannot always predict the impact that our risk management decisions may have on us if actual events result in greater losses or costs than our risk models predict or greater volatility in our earnings and financial position.

In addition, our trading, marketing and hedging activities are exposed to counterparty credit risk and market liquidity risk. We have adopted a credit risk management policy and program to evaluate counterparty credit risk. However, if counterparties fail to perform, the risk of which has increased due to the economic downturn, we may be forced to enter into alternative arrangements at then-current market prices. In that event, our financial results are likely to be adversely affected.

***We do not always hedge against risks associated with electricity and fuel price volatility.***

We attempt to mitigate risks associated with satisfying our contractual electricity sales obligations by either reserving generation capacity to deliver electricity or purchasing the necessary financial or physical products and services through competitive markets to satisfy our net firm sales contracts. We also routinely enter into contracts, such as fuel and electricity purchase and sale commitments, to hedge our exposure to fuel requirements and other electricity-related commodities. However, based on economic and other considerations, we may not hedge the entire exposure of our operations from commodity price volatility. To the extent we do not hedge against commodity price volatility, our results of operations and financial position may be adversely affected.

***We face intense competition in our energy supply business, which may adversely affect our ability to operate profitably.***

Unlike our regulated delivery businesses, our energy supply business is dependent on our ability to operate in a competitive environment and is not assured of any rate of return on capital investments through a predetermined rate structure. Competition is impacted by electricity and fuel prices, new market entrants, construction by others of generating assets and transmission capacity, technological advances in power generation, the actions of environmental and other regulatory authorities and other factors. These competitive factors may negatively impact our ability to sell electricity and related products and services, as well as the prices that we may charge for such products and services, which could adversely affect our results of operations and our ability to grow our business.

We sell our available energy and capacity into the competitive wholesale markets through contracts with various durations. Competition in the wholesale power markets occurs principally on the basis of the price of products and, to a lesser extent, on the basis of reliability and availability. We believe that the commencement of commercial operation of new electric facilities in the regional markets where we own or control generation capacity and the evolution of demand side management resources will continue to increase the competitiveness of the wholesale electricity market in those regions, which could have a material adverse effect on the prices we receive for electricity.

We also face competition in the wholesale markets for electricity capacity and ancillary services. We primarily compete with other electricity suppliers based on our ability to aggregate supplies at competitive prices from different sources and to efficiently utilize transportation from third-party pipelines and transmission from electric utilities and ISOs. We also compete against other energy marketers on the basis of relative financial condition and access to credit sources, and our competitors may have greater financial resources than we have.

Competitors in the wholesale power markets in which PPL Generation subsidiaries and PPL EnergyPlus operate include regulated utilities, industrial companies, non-utility generators and unregulated subsidiaries of regulated utilities. In the past, PUHCA significantly restricted mergers and acquisitions and other investments in the electric utility sector. Entirely new competitors, including financial institutions, have entered the energy markets as a result of the repeal of PUHCA. The repeal of PUHCA also may lead to consolidation in our industry, resulting in competitors with significantly greater financial resources than we have.

***Disruptions in our fuel supplies could occur, which could adversely affect our ability to operate our generation facilities.***

We purchase fuel from a number of suppliers. Disruption in the delivery of fuel and other products consumed during the production of electricity (such as lime, limestone and other chemicals), including disruptions as a result of weather, transportation difficulties, global demand and supply dynamics, labor relations, environmental regulations or the financial viability of our fuel suppliers, could adversely affect our ability to operate our facilities, which could result in lower sales and/or higher costs and thereby adversely affect our results of operations.

***Despite federal and state deregulation initiatives, our supply business is still subject to extensive regulation, which may increase our costs, reduce our revenues, or prevent or delay operation of our facilities.***

Our generation subsidiaries sell electricity into the wholesale market. Generally, our generation subsidiaries and our marketing subsidiaries are subject to regulation by the FERC. The FERC has authorized us to sell generation from our facilities and power from our marketing subsidiaries at market-based prices. The FERC retains the authority to modify or withdraw our market-based rate authority and to impose "cost of service" rates if it determines that the market is not competitive, that we possess market power or that we are not charging just and reasonable rates. Any reduction by the FERC in the rates we may receive or any unfavorable regulation of our business by state regulators could materially adversely affect our results of operations. See "FERC Market-Based Rate Authority" in Note 14 to the Financial Statements

for information regarding recent court decisions that could impact the FERC's market-based rate authority program, and "PJM RPM Litigation" in Note 14 to the Financial Statements for information regarding the FERC's proceedings that could impact PJM's capacity pricing model.

In addition, the acquisition, construction, ownership and operation of electricity generation facilities require numerous permits, approvals, licenses and certificates from federal, state and local governmental agencies. We may not be able to obtain or maintain all required regulatory approvals. If there is a delay in obtaining any required regulatory approvals or if we fail to obtain or maintain any required approval or fail to comply with any applicable law or regulation, the operation of our assets and our sales of electricity could be prevented or delayed or become subject to additional costs.

***Our generation facilities may not operate as planned, which may increase our expenses or decrease our revenues and, thus, have an adverse effect on our financial performance.***

Our ability to manage operational risk with respect to our generation plants is critical to our financial performance. Operation of our power plants at expected capacity levels involves many risks, including the breakdown or failure of equipment or processes, accidents, labor disputes and fuel interruption. In addition, weather and natural disasters can disrupt our generation plants. Weather conditions also have a direct impact on the river flows required to operate our hydroelectric plants at expected capacity levels. Depending on the timing and duration of both planned and unplanned, complete or partial outages at our power plants (in particular, if such outages are during peak periods or during periods of, or caused by, severe weather), or if our planned uprates at power plants are not completed as scheduled, our revenues from expected energy sales could significantly decrease and our expenses significantly increase, and we could be required to purchase power at then-current market prices to satisfy our energy sales commitments or, in the alternative, pay penalties and damages for failure to satisfy them. Many of our generating units are reaching mid-life, and we face the potential for more frequent unplanned outages and the possibility of planned outages of longer duration to accommodate significant investments in major component replacements at these facilities.

***Changes in technology may negatively impact the value of our power plants.***

A basic premise of our business is that generating electricity at central power plants achieves economies of scale and produces electricity at relatively low prices. There are alternate technologies to produce electricity, most notably fuel cells, microturbines, windmills and photovoltaic (solar) cells, the development of which has been expanded due to global climate change concerns. Research and development activities are ongoing to seek improvements in alternate technologies. It is possible that advances will reduce the cost of alternate methods of electricity production to a level that is equal to or below that of certain central station production. Also, as new technologies are developed and become available, the quantity and pattern of electricity usage (the "demand") by customers could decline, with a corresponding decline in revenues derived by generators. These alternative energy sources could result in a decline to the dispatch and capacity factors of our plants. As a result of all of these factors, the value of our generation facilities could be significantly reduced.

***The load following contracts that PPL EnergyPlus is awarded do not provide for specific levels of load, and actual load significantly below or above our forecasts could adversely affect our energy margins.***

We generally hedge our load following obligations with energy purchases from third parties, and to a lesser extent with its owned generation. If the actual load is significantly lower than the expected load, we may be required to resell power at a lower price than was purchased to supply the load obligation, resulting in a financial loss. Alternatively, a significant increase in load could adversely affect our energy margins because we are required under the terms of the load following contracts to provide the energy necessary to fulfill increased demand at the contract price, which could be lower than the cost to procure additional energy on the open market. Therefore, any significant decrease or increase in load compared to our forecasts, could have a material adverse effect on our results of operations or financial position.

***Our earnings may be affected by whether we decide to, or are able to, continue to enter into or renew long-term power sale, fuel purchase and fuel transportation agreements to mitigate market price and supply risk.***

As a result of the PLR contracts and certain other agreements, a substantial portion of our generation production and capacity value was committed through 2009 under power sales agreements of various terms that included fixed prices for electric power. With the expiration of these agreements we have been actively selling our generation at fixed prices in the wholesale energy market and participating in load-following or full requirements auctions with utility companies in the PJM, New England Power Pool and Midwest ISO regions. In connection with these activities, we have entered into longer-term fuel purchase and fuel transportation agreements that include fixed prices for a significant portion of our forecasted needs. Whether we decide to, or are able to, continue to enter into such agreements or renew existing agreements in the future, prevailing market conditions will affect our financial performance. For example, in the absence of long-term power sales agreements, we would sell the energy, capacity and other products from our facilities in the competitive wholesale power markets under contracts of shorter duration at then-current market prices. Current forward prices for electricity are lower than the prices under some of our existing power sales agreements. In addition, if we do not secure or maintain favorable fuel purchase and transportation agreements for our power generation facilities, our fuel costs (and associated fuel transportation costs) could exceed the revenues we derive from our energy sales. Given the volatility and potential for material differences between actual electricity prices and fuel and other costs, if we do not secure or maintain long-term electricity sales and fuel purchase and fuel transportation agreements, our margins will be subject to increased volatility and, depending on future electricity and fuel costs (and associated fuel transportation costs), our financial results may be materially adversely affected.

***If market deregulation is reversed or discontinued, our business prospects and financial condition could be materially adversely affected.***

In some markets, state legislators, government agencies and other interested parties have made proposals to change the use of market-based pricing, re-regulate areas of these markets that have previously been deregulated or permit electricity delivery companies to construct or acquire generating facilities. The ISOs that oversee the transmission systems in certain wholesale electricity markets have from time to time

been authorized to impose price limitations and other mechanisms to address volatility in the power markets. These types of price limitations and other mechanisms may reduce profits that our wholesale power marketing and trading business would have realized under competitive market conditions absent such limitations and mechanisms. Although we generally expect electricity markets to continue to be competitive, other proposals to re-regulate our industry may be made, and legislative or other action affecting the electric power restructuring process may use the process to be delayed, discontinued or reversed in states in which we currently, or may in the future, operate.

***We rely on transmission and distribution assets that we do not own or control to deliver our wholesale electricity. If transmission is disrupted, or not operated efficiently, or if capacity is inadequate, our ability to sell and deliver power may be hindered.***

We depend on transmission and distribution facilities owned and operated by utilities and other energy companies to deliver the electricity and natural gas we sell to the wholesale market, as well as the natural gas we purchase for use in our electric generation facilities. If transmission is disrupted (as a result of weather, natural disasters or other reasons) or not operated efficiently by ISOs, in applicable markets, or if capacity is inadequate, our ability to sell and deliver products and satisfy our contractual obligations may be hindered, or we may be unable to sell products on the most favorable terms.

The FERC has issued regulations that require wholesale electric transmission services to be offered on an open-access, non-discriminatory basis. Although these regulations are designed to encourage competition in wholesale market transactions for electricity, there is the potential that fair and equal access to transmission systems will not be available or that transmission capacity will not be available in the amounts we desire. We cannot predict the timing of industry changes as a result of these initiatives or the adequacy of transmission facilities in specific markets or whether ISOs in applicable markets will efficiently operate transmission networks and provide related services.

***Our costs to comply with existing and new environmental laws are expected to continue to be significant, and we plan to incur significant capital expenditures for pollution control improvements that, if delayed, would adversely affect our profitability and liquidity.***

Our business is subject to extensive federal, state and local statutes, rules and regulations relating to environmental protection. To comply with existing and future environmental requirements and as a result of voluntary pollution control measures we may take, we have spent and expect to spend substantial amounts in the future on environmental control and compliance.

In order to comply with existing and recently enacted federal and state environmental laws and regulations primarily governing air emissions from coal-fired plants, in 2005 PPL began a program to install scrubbers and other pollution control equipment (primarily aimed at sulfur dioxide, particulate and nitrogen oxides with co-benefits for mercury emissions reduction). The cost to install this equipment was approximately \$1.6 billion, of which \$19 million remains to be spent. The remaining unspent balance is included in the 2010 through 2012 capital budget. The scrubbers at our Montour and Brunner Island plants are now in service. Many states and environmental groups have challenged certain federal laws and regulations relating to air emissions as not being sufficiently strict. As a result, it is possible that state and federal regulations will be adopted that impose more stringent restrictions than are currently in effect, which could require us to significantly increase capital expenditures for pollution control equipment.

We may not be able to obtain or maintain all environmental regulatory approvals necessary for our planned capital projects or which are otherwise necessary to our business. If there is a delay in obtaining any required environmental regulatory approval or if we fail to obtain, maintain or comply with any such approval, operations at our affected facilities could be halted or subjected to additional costs. Furthermore, at some of our older generating facilities it may be uneconomic for us to install necessary equipment, which could cause us to close those units.

Additionally, the expanding national and international focus on climate change and the related desire to reduce carbon dioxide and other greenhouse gas emissions has led to numerous federal legislative and regulatory proposals, and several states already have passed legislation capping carbon dioxide emissions. The continuation of this trend may heighten or make more likely the risks identified above.

For more information regarding environmental matters, including existing and proposed federal, state and local statutes, rules and regulations to which we are subject, see "Environmental Matters - Domestic" in Note 14 to the Financial Statements.

***We are subject to the risks of nuclear generation, including the risk that our Susquehanna nuclear plant could become subject to revised security or safety requirements that would increase our capital and operating expenditures, and uncertainties associated with decommissioning our plant at the end of its licensed life.***

Nuclear generation accounted for about 32% of our 2009 generation output. The risks of nuclear generation generally include:

- the potential harmful effects on the environment and human health from the operation of nuclear facilities and the storage, handling and disposal of radioactive materials;
- limitations on the amounts and types of insurance commercially available to cover losses and liabilities that might arise in connection with nuclear operations; and
- uncertainties with respect to the technological and financial aspects of decommissioning nuclear plants at the end of their licensed lives. The licenses for our two nuclear units expire in 2042 and 2044. See Note 20 to the Financial Statements for additional information on the ARO related to the decommissioning.

The NRC has broad authority under federal law to impose licensing requirements, including security, safety and employee-related requirements for the operation of nuclear generation facilities. In the event of noncompliance, the NRC has authority to impose fines or shut down a unit, or both, depending upon its assessment of the severity of the situation, until compliance is achieved. In addition, revised security or safety requirements promulgated by the NRC could necessitate substantial capital or operating expenditures at our Susquehanna nuclear plant. In addition, although we have no reason to anticipate a serious nuclear incident at our Susquehanna plant, if an incident did occur, any resulting

operational loss, damages and injuries could have a material adverse effect on our results of operations, cash flows or financial condition.

### **Risks Related to International Delivery Segment**

*( PPL and PPL Energy Supply )*

***Our U.K. delivery business is subject to risks with respect to rate regulation and operational performance.***

Our U.K. delivery business is rate regulated and operates under an incentive-based regulatory framework. In addition, its ability to manage operational risk is critical to its financial performance. Disruption to the distribution network could reduce profitability both directly through the higher costs for network restoration and also through the system of penalties and rewards that Ofgem has in place relating to customer service levels.

In December 2009, Ofgem completed its rate review for the five-year period from April 1, 2010 through March 31, 2015, thus reducing regulatory rate risk in the International Delivery Segment until the next rate review which will be effective April 1, 2015. The results of the rate review are further discussed in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Results of Operations." The regulated income of the International Delivery Segment and also the RAB are to some extent linked to movements in the Retail Price Index (RPI). Reductions in the RPI would adversely impact revenues and the debt/RAB ratio.

***Our U.K. delivery business exposes us to risks related to U.K. laws and regulations, taxes, economic conditions, foreign currency exchange rate fluctuations, and political conditions and policies of the U.K. government. These risks may reduce the results of operations from our U.K. delivery business.***

The acquisition, financing, development and operation of projects in the U.K. entail significant financial risks including:

- changes in laws or regulations relating to U.K. operations, including tax laws and regulations;
- changes in government policies, personnel or approval requirements;
- changes in general economic conditions affecting the U.K.;
- regulatory reviews of tariffs for distribution companies;
- severe weather and natural disaster impacts on the electric sector and our assets;
- changes in labor relations;
- limitations on foreign investment or ownership of projects and returns or distributions to foreign investors;
- limitations on the ability of foreign companies to borrow money from foreign lenders and lack of local capital or loans; fluctuations in currency exchange rates and in converting U.K. revenues to U.S. dollars, which can increase our expenses and/or impair our ability to meet such expenses, and difficulty moving funds out of the country in which the funds were earned; and
- compliance with U.S. foreign corrupt practices laws.

### **Risks Related to Pennsylvania Delivery Segment**

*( PPL and PPL Electric )*

***Regulators may not approve the rates we request.***

Our Pennsylvania delivery business is rate-regulated. While such regulation is generally premised on the recovery of prudently incurred costs, including energy supply costs for customers, and a reasonable rate of return on invested capital, the rates that we may charge our delivery customers are subject to authorization of the applicable regulatory authorities. Our Pennsylvania delivery business is subject to substantial capital expenditure requirements over the next several years, which will require rate increase requests to the regulators. There is no guarantee that the rates authorized by regulators will match our actual costs or provide a particular return on invested capital at any given time.

***Our transmission and distribution facilities may not operate as planned, which may increase our expenses or decrease our revenues and, thus, have an adverse effect on our financial performance.***

Our ability to manage operational risk with respect to our transmission and distribution systems is critical to the financial performance of our delivery business. Our delivery business also faces several risks, including the breakdown or failure of or damage to equipment or processes (especially due to severe weather or natural disasters), accidents and labor disputes and other factors. Operation of our delivery systems below our expectations may result in lost revenues or increased expenses, including higher maintenance costs.

***We may be subject to higher transmission costs and other risks as a result of PJM's regional transmission expansion plan (RTEP) process.***

PJM and the FERC have the authority to require upgrades or expansion of the regional transmission grid, which can result in substantial expenditures for transmission owners. As discussed in Note 8 to the Financial Statements, we expect to make substantial expenditures to construct the Susquehanna-Roseland transmission line that PJM has determined is necessary for the reliability of the regional transmission grid. Although the FERC has granted our request for incentive rate treatment of such facilities, we cannot predict the date when these facilities will be in service or whether delays may occur due to public opposition or other factors. Delays could result in significant cost increases for these facilities and decreased reliability of the regional transmission grid. As a result, we cannot predict the ultimate financial or operational impact of this project or other RTEP projects on PPL Electric.

***We could be subject to higher costs and/or penalties related to mandatory reliability standards.***

Under the Energy Policy Act, owners and operators of the bulk power transmission system are now subject to mandatory reliability standards promulgated by the NERC and enforced by the FERC. Compliance with reliability standards may subject us to higher operating costs and/or increased capital expenditures, and violations of these standards could result in substantial penalties.

***We could be subject to higher costs and/or penalties related to Pennsylvania Conservation and Energy Efficiency Programs.***

Act 129 became effective in October 2008. This law created requirements for energy efficiency and conservation programs and for the use of smart metering technology, imposed new PLR electricity supply procurement rules, provided remedies for market misconduct, and made changes to the existing Alternative Energy Portfolio Standard. Utilities not meeting the requirements of Act 129 are subject to significant penalties that cannot be recovered in rates. The law also requires electric utilities to meet specified goals for reduction in customer electricity usage and peak demand by specified dates (2011 and 2013). Although we expect to meet these requirements, numerous factors outside of our control could prevent compliance with these requirements and result in penalties to us. See "Regulatory Issues - Energy Policy Act of 2005 - Reliability Standards" in Note 14 to the Financial Statements for additional information.

***Rate deregulation remains subject to political risks.***

Although prior initiatives have not resulted in the enactment of legislation, the possibility remains that certain Pennsylvania legislators could introduce legislation to extend generation rate caps or otherwise limit cost recovery through rates for Pennsylvania utilities after the end of applicable transition periods, which in PPL Electric's case was December 31, 2009. If such legislation were introduced and ultimately enacted, PPL Electric could face severe financial consequences including operating losses and significant cash flow shortfalls. In addition, continuing uncertainty regarding PPL Electric's ability to recover its market supply and other costs of operating its business could adversely affect its credit quality, financing costs and availability of credit facilities necessary to operate its business.

**Other Risks Related to All Segments**

( PPL, PPL Energy Supply and PPL Electric )

***We will selectively pursue growth of generation and transmission and distribution capacity, which involves a number of uncertainties and may not achieve the desired financial results.***

We will pursue expansion of our generation and transmission and distribution capacity over the next several years through power uprates at certain of our existing power plants, the potential construction of new power plants, the potential acquisition of existing plants, the potential construction or acquisition of transmission and distribution projects and capital investments to upgrade transmission and distribution infrastructure. We will rigorously scrutinize opportunities to expand our generating capability and may determine not to proceed with any expansion. These types of projects involve numerous risks. Any planned power uprates could result in cost overruns, reduced plant efficiency and higher operating and other costs. With respect to the construction of new plants, the acquisition of existing plants, or the construction or acquisition of transmission and distribution projects, we may be required to expend significant sums for preliminary engineering, permitting, resource exploration, legal and other expenses before it can be established whether a project is feasible, economically attractive or capable of being financed. The success of both a new or acquired project would likely be contingent, among other things, upon the negotiation of satisfactory operating contracts, obtaining acceptable financing, maintaining acceptable credit ratings, as well as receipt of required and appropriate governmental approvals. If we were unable to complete construction or expansion of a facility, we would generally be unable to recover our investment in the project. Furthermore, we might be unable to run any new or acquired plants as efficiently as projected, which could result in higher than projected operating and other costs and reduced earnings.

***The economic and financial markets in which we operate could adversely affect our financial condition and results of operations.***

In 2008, conditions in the financial markets became disruptive to the processes of managing credit risk, responding to liquidity needs, measuring at fair value derivatives and other financial instruments and managing market risk. The contraction of liquidity in the wholesale energy markets and accompanying significant decline in wholesale energy prices significantly impacted our earnings during the second half of 2008 and the first half of 2009. The breadth and depth of these negative economic conditions had a wide-ranging impact on the U.S. and international business environment, including our businesses, and may continue to do so. As a result of the economic downturn, demand for energy commodities has declined significantly. This reduced demand will continue to impact the key domestic wholesale energy markets we serve (such as PJM) and our Pennsylvania delivery business, especially industrial customer demand. The combination of lower demand for power and natural gas and other fuels has put downward price pressure on the wholesale energy market in general, further impacting our energy marketing results. In general, current economic and commodity market conditions will continue to challenge the predictability regarding our unhedged future energy margins, liquidity and overall financial condition.

Our businesses are heavily dependent on credit and capital, among other things, for providing collateral to support hedging in our energy marketing business. Global bank credit capacity was reduced and the cost of renewing or establishing new credit facilities increased significantly in 2008, primarily as a result of general credit concerns nationwide, thereby introducing uncertainties as to our businesses' ability to enter into long-term energy commitments or reliably estimate the longer-term cost and availability of credit. Although bank credit conditions have improved since mid-2009, and we currently expect to have adequate access to needed credit and capital based on current conditions, deterioration in the financial markets could adversely affect our financial condition and liquidity.

The current condition of the economic and financial markets in which we operate is expected to continue to impact numerous other aspects of our business operations discussed elsewhere in this Risk Factor section.

***Our operating results could fluctuate on a seasonal basis, especially as a result of severe weather conditions.***

Our businesses are subject to seasonal demand cycles. For example, in some markets demand for, and market prices of, electricity peak during the summer months, while in other markets such peaks occur in cold winter months. As a result, our overall operating results in the future may fluctuate substantially on a seasonal basis if weather conditions such as heat waves, extreme cold weather or severe storms occur. The patterns of these fluctuations may change depending on the type and location of our facilities and the terms of our contracts to sell electricity.

***We cannot predict the outcome of the legal proceedings and investigations currently being conducted with respect to our current and past business activities. An adverse determination could have a material adverse effect on our financial condition, results of operations or cash flows.***

We are involved in legal proceedings, claims and litigation and subject to ongoing state and federal investigations arising out of our business operations, the most significant of which are summarized in "Legal Matters," "Regulatory Issues" and in "Environmental Matters - Domestic" in Note 14 to the Financial Statements. We cannot predict the ultimate outcome of these matters, nor can we reasonably estimate the costs or liability that could potentially result from a negative outcome in each case.

***We may need significant additional financing to pursue growth opportunities.***

We continually review potential acquisitions and development projects and may enter into significant acquisition agreements or development commitments in the future. An acquisition agreement or development commitment may require access to substantial capital from outside sources on acceptable terms. We also may need external financing to fund capital expenditures, including capital expenditures necessary to comply with environmental or other regulatory requirements. Our ability to arrange financing and our cost of capital are dependent on numerous factors, including general economic conditions, credit availability and our financial performance. The inability to obtain sufficient financing on terms that are acceptable to us could adversely affect our ability to pursue acquisition and development opportunities and fund capital expenditures.

***A downgrade in our credit ratings could negatively affect our ability to access capital and increase the cost of maintaining our credit facilities and any new debt.***

Our current credit ratings by Moody's, Fitch and S&P, including a January 2009 review by S&P that resulted in a negative outlook for us, are listed in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Financial Condition - Liquidity and Capital Resources - Credit Ratings." While we do not expect these ratings to limit our ability to fund short-term liquidity needs or access new long-term debt, any ratings downgrade could increase our short-term borrowing costs and negatively affect our ability to fund short-term liquidity needs and access new long-term debt. See "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Financial Condition - Liquidity and Capital Resources - Ratings Triggers" for additional information on the impact of a downgrade in our credit rating.

***Significant increases in our operation and maintenance expenses, including health care and pension costs, could adversely affect our future earnings and liquidity.***

We continually focus on limiting and reducing where possible our operation and maintenance expenses. However, we expect to continue to face increased cost pressures in our operations. Increased costs of materials and labor may result from general inflation, increased regulatory requirements, especially in respect of environmental protection, the need for higher cost expertise in the workforce or other factors. In addition, pursuant to collective bargaining agreements, we are contractually committed to provide specified levels of health care and pension benefits to certain current employees and retirees. We provide a similar level of benefits to our management employees. These benefits give rise to significant expenses. Due to general inflation with respect to such costs, the aging demographics of our workforce and other factors, we have experienced significant health care cost inflation in recent years, and we expect our health care costs, including prescription drug coverage, to continue to increase despite measures that we have taken and expect to take to require employees and retirees to bear a higher portion of the costs of their health care benefits. In addition, we expect to continue to incur significant costs with respect to the defined benefit pension plans for our employees and retirees. The measurement of our expected future health care and pension obligations, costs and liabilities is highly dependent on a variety of assumptions, most of which relate to factors beyond our control. These assumptions include investment returns, interest rates, health care cost trends, benefit improvements, salary increases and the demographics of plan participants. If our assumptions prove to be inaccurate, our future costs and cash contribution requirements to fund these benefits could increase significantly.

***There is a risk that we may be required to record impairment charges in the future for certain of our investments, which could adversely affect our earnings.***

Under GAAP, we are required to test our recorded goodwill for impairment on an annual basis, or more frequently if events or circumstances indicate that these assets may be impaired. Although no goodwill impairments were recorded based on our annual review in the fourth quarter of 2009, we are unable to predict whether future impairment charges may be necessary.

We also review our long-lived assets for impairment when events or circumstances indicate that the carrying value of these assets may not be recoverable. During 2009, PPL recorded impairment charges related to certain sulfur dioxide emission allowances and the Long Island generation business that is being sold. During 2008, PPL recorded impairment charges related to a cancelled hydroelectric expansion project, certain emission allowances and its natural gas distribution and propane businesses that were sold in 2008. During 2007, PPL impaired certain transmission rights, certain domestic telecommunications assets, certain assets of the natural gas distribution and propane businesses, and the net assets of our Bolivian businesses prior to their sale in 2007. See Notes 8, 9 and 17 to the Financial Statements for additional information on

these charges. We are unable to predict whether impairment charges, or other losses on sales of other assets or businesses, may occur in future years.

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**ITEM 1B. UNRESOLVED STAFF COMMENTS**

**PPL Corporation, PPL Energy Supply, LLC and PPL Electric Utilities Corporation**

None.

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## ITEM 2. PROPERTIES

### Supply Segment

PPL Energy Supply's system capacity (winter rating) at December 31, 2009, was:

Plant	Total MW Capacity (a)	% Ownership	PPL Energy Supply's Ownership or Lease Interest in MW	Primary Fuel
<b>Pennsylvania</b>				
Susquehanna	2,451	90.00	2,206	Nuclear
Montour	1,530	100.00	1,530	Coal
Brunner Island	1,476	100.00	1,476 (b)	Coal
Martins Creek	1,672	100.00	1,672	Natural Gas/Oil
Keystone	1,718	12.34	212	Coal
Conemaugh	1,718	16.25	279	Coal
Ironwood (c)	759	100.00	759	Natural Gas
Lower Mt. Bethel	624	100.00	624	Natural Gas
Combustion turbines	465	100.00	465	Natural Gas/Oil
Safe Harbor Water Power Corp.	421	33.33	140	Hydro
Hydroelectric	172	100.00	172	Hydro
Other (c) (d)	48	100.00	48	Various
	13,054		9,583	
<b>Montana</b>				
Colstrip Units 1 & 2	614	50.00	307	Coal
Colstrip Unit 3	740	30.00	222	Coal
Corette	153	100.00	153	Coal
Hydroelectric	604	100.00	604	Hydro
	2,111		1,286	
<b>Illinois</b>				
University Park	585	100.00	585	Natural Gas
<b>Connecticut</b>				
Wallingford	244	100.00	244	Natural Gas
<b>New York</b>				
Shoreham and Edgewood	159	100.00	(e)	Natural Gas/Oil
<b>Maine</b>				
Hydroelectric	12	100.00	12	Hydro
<b>New Jersey</b>				
Other	11	100.00	5 (f)	Landfill Gas/Solar
<b>Vermont</b>				
Moretown	3	100.00	3	Landfill Gas
<b>New Hampshire</b>				
Colebrook	1	100.00	1	Landfill Gas
Total System Capacity	16,180		11,719	

(a) The capacity of generation units is based on a number of factors, including the operating experience and physical conditions of the units, and may be revised periodically to reflect changed circumstances.

(b) PPL Energy Supply expects a reduction of up to 30 MW in net generation capability due to the estimated increase in station service usage during the scrubber operation.

(c) Facilities not owned by PPL Energy Supply, but there is a tolling agreement or power purchase agreement in place.

1) Includes renewable energy facilities owned by a PPL Energy Supply subsidiary.

2) Facilities owned by PPL Energy Supply, but there are tolling agreements in place for 100% of the output. In May 2009, PPL Generation signed a definitive agreement to sell the Long Island generation business. The tolling agreements related to these plants will be transferred to the new owner upon completion of the sale. See Note 9 to the Financial Statements for additional information on the anticipated sale.

(f) Includes renewable energy facilities owned by a PPL Energy Supply subsidiary for which there are power purchase agreements in place.

PPL Energy Supply continuously reexamines development projects based on market conditions and other factors to determine whether to proceed with the projects, sell, cancel or expand them, execute tolling agreements or pursue other options. At December 31, 2009, PPL Energy Supply generation planned to implement the following incremental capacity increases.

<u>Project</u>	<u>Primary Fuel</u>	<u>Total MW Capacity (a)</u>	<u>PPL Energy Supply Ownership or Lease Interest in MW</u>	<u>Expected In-Service Date (b)</u>
<b>Pennsylvania</b>				
Holtwood (c)	Hydro	125	125 (100%)	2013
Susquehanna (d)	Nuclear	59	53 (90%)	2010 - 2011
Martins Creek (e)	Natural Gas/Oil	30	30 (100%)	2011
Chrin Landfill	Landfill Gas	3	3 (100%)	2011
<b>Montana</b>				
Great Falls (f)	Hydro	28	28 (100%)	2012
<b>Total</b>		<u>245</u>	<u>239</u>	

(a) The capacity of generation units is based on a number of factors, including the operating experience and physical condition of the units, and may be revised periodically to reflect changed circumstances.

(b) The expected in-service dates are subject to receipt of required approvals, permits and other contingencies.

(c) This project includes installation of two additional large turbine-generators.

(d) This project involves the extended upgrade of Units 1 and 2 and is being implemented in two uprates per unit, the first increase being an average of 50 MW per unit. The first uprate for Unit 1 occurred in 2008. The second uprate is planned to occur in 2010. The first uprate for Unit 2 occurred in 2009. The second uprate is planned to occur in 2011.

(e) This project involves the replacement of LP rotors and stationary blading for Unit 4.

(f) This project involves reconstruction of a powerhouse.

#### Pennsylvania Delivery Segment

For a description of PPL Electric's service territory, see "Item 1. Business - Background." At December 31, 2009, PPL Electric had electric transmission and distribution lines in public streets and highways pursuant to franchises and rights-of-way secured from property owners. PPL Electric's system included 371 substations with a total capacity of 30 million kVA, 33,053 circuit miles of overhead lines and 7,310 cable miles of underground conductors. All of PPL Electric's facilities are located in Pennsylvania. Substantially all of PPL Electric's distribution properties and certain transmission properties are subject to the lien of PPL Electric's 2001 Senior Secured Bond Indenture.

See Note 8 to the Financial Statements for information on the construction of a new 500-kilovolt transmission line.

#### International Delivery Segment

For a description of WPD's service territory, see "Item 1. Business - Background." At December 31, 2009, WPD had electric distribution lines in public streets and highways pursuant to legislation and rights-of-way secured from property owners. In 2009, electricity distributed totaled 26,358 GWh based on operating revenues recorded by WPD. WPD's distribution system in the U.K. includes 651 substations with a total capacity of 25 million kVA, 28,877 miles of overhead lines and 23,896 cable miles of underground conductors.

### **ITEM 3. LEGAL PROCEEDINGS**

See Note 14 to the Financial Statements for information regarding legal, regulatory and environmental proceedings and matters.

### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

There were no matters submitted to a vote of security holders, through the solicitation of proxies or otherwise, during the fourth quarter of 2009.

## EXECUTIVE OFFICERS OF THE REGISTRANTS

Officers of PPL, PPL Energy Supply and PPL Electric are elected annually by their Boards of Directors (or Board of Managers for PPL Energy Supply) to serve at the pleasure of the respective Boards. There are no family relationships among any of the executive officers, nor is there any arrangement or understanding between any executive officer and any other person pursuant to which the officer was selected.

There have been no events under any bankruptcy act, no criminal proceedings and no judgments or injunctions material to the evaluation of the ability and integrity of any executive officer during the past five years.

Listed below are the executive officers at December 31, 2009.

### **PPL Corporation**

<u>Name</u>	<u>Age</u>	<u>Positions Held During the Past Five Years</u>	<u>Dates</u>
James H. Miller	61	Chairman, President and Chief Executive Officer President President and Chief Operating Officer Executive Vice President and Chief Operating Officer	October 2006 - present June 2006 - September 2006 August 2005 - June 2006 September 2004 - July 2005
William H. Spence	52	Executive Vice President and Chief Operating Officer President-PPL Generation Senior Vice President-Pepco Holdings, Inc. Senior Vice President-Conectiv Holdings	June 2006 - present June 2008 - present August 2002 - June 2006 September 2000 - June 2006
Paul A. Farr	42	Executive Vice President and Chief Financial Officer Senior Vice President-Financial Senior Vice President-Financial and Controller Vice President and Controller	April 2007 - present January 2006 - March 2007 August 2005 - January 2006 August 2004 - July 2005
Robert J. Grey	59	Senior Vice President, General Counsel and Secretary	March 1996 - present
Robert D. Gabbard (a)	50	President-PPL EnergyPlus Senior Vice President-Trading-PPL EnergyPlus Senior Vice President Merchant Trading Operations-Conectiv Energy Vice President and General Manager Power Trading-Conectiv Energy	June 2008 - present June 2008 - June 2008 June 2005 - May 2008 April 1998 - June 2005
Rick L. Klingensmith (a)	49	President-PPL Global	August 2004 - present
David G. DeCampli (a)	52	President-PPL Electric Senior Vice President-Transmission and Distribution Engineering and Operations-PPL Electric Vice President-Asset Investment Strategy and Development-Exelon Energy Delivery-Exelon Corporation	April 2007 - present December 2006 - April 2007 April 2004 - December 2006
James E. Abel	58	Vice President-Finance and Treasurer	June 1999 - present
J. Matt Simmons, Jr.	44	Vice President and Controller Vice President-Finance and Controller-Duke Energy Americas	January 2006 - present October 2003 - January 2006

(a) Designated an executive officer of PPL by virtue of their respective positions at a PPL subsidiary.

### **PPL Electric Utilities Corporation**

<u>Name</u>	<u>Age</u>	<u>Positions Held During the Past Five Years</u>	<u>Dates</u>
David G. DeCampli	52	President Senior Vice President-Transmission and Distribution Engineering and Operations Vice President-Asset Investment Strategy and Development-Exelon Energy Delivery-Exelon Corporation	April 2007 - present December 2006 - April 2007 April 2004 - December 2006
Gregory N. Dudkin (a)	52	Senior Vice President-Operations Independent Consultant	June 2009 - present February 2009 - June 2009

		Senior Vice President of Technical Operations and Fulfillment- Comcast Corporation	July 2006 - January 2009
		Regional Senior Vice President-Comcast Corporation	January 2005 - June 2006
James E. Abel	58	Treasurer	July 2000 - present
J. Matt Simmons, Jr.	44	Vice President and Controller Vice President-Finance and Controller-Duke Energy Americas	January 2006 - present October 2003 - January 2006

(a) On June 29, 2009, Gregory N. Dudkin was elected Senior Vice President-Operations of PPL Electric.

**PPL Energy Supply, LLC**

Item 4 is omitted as PPL Energy Supply meets the conditions set forth in General Instruction (I)(1)(a) and (b) of Form 10-K.

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## PART II

### ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

#### PPL Corporation

Additional information for this item is set forth in the sections entitled "Quarterly Financial, Common Stock Price and Dividend Data," "Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters" and "Shareowner and Investor Information" of this report. At January 29, 2010, there were 72,013 common stock shareowners of record.

#### Issuer Purchases of Equity Securities during the Fourth Quarter of 2009:

	(a)	(b)	(c)	(d)
Period	Total Number of Shares (or Units) Purchased (1)	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs (2)	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs (2)
October 1 to October 31, 2009				\$57,495
November 1 to November 30, 2009	14,124	\$29.44		\$57,495
December 1 to December 31, 2009				\$57,495
Total	14,124	\$29.44		\$57,495

- (1) Represents shares of common stock withheld by PPL at the request of its executive officers to pay taxes upon the vesting of the officers' restricted stock awards, as permitted under the terms of PPL's ICP and ICPKE.
- (2) In June 2007, PPL announced a program to repurchase from time to time up to \$750 million of its common stock in open market purchases, pre-arranged trading plans or privately negotiated transactions.

#### PPL Energy Supply, LLC

There is no established public trading market for PPL Energy Supply's membership interests. PPL Energy Funding, a direct wholly owned subsidiary of PPL, owns all of PPL Energy Supply's outstanding membership interests. Distributions on the membership interests will be paid as determined by PPL Energy Supply's Board of Managers. PPL Energy Supply made cash distributions to PPL Energy Funding of \$943 million in 2009 and \$750 million in 2008.

#### PPL Electric Utilities Corporation

There is no established public trading market for PPL Electric's common stock, as PPL owns 100% of the outstanding common shares. Dividends paid to PPL on those common shares are determined by PPL Electric's Board of Directors. PPL Electric paid common stock dividends to PPL of \$274 million in 2009 and \$98 million in 2008.

### ITEM 6. SELECTED FINANCIAL AND OPERATING DATA

#### PPL Energy Supply, LLC

Item 6 is omitted as PPL Energy Supply meets the conditions set forth in General Instructions (I)(1)(a) and (b) of Form 10-K.

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**ITEM 6. SELECTED FINANCIAL AND OPERATING DATA**

<b>PPL Corporation (a)(b)</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
<b>Income Items - millions</b>					
Operating revenues	\$ 7,556	\$ 8,007	\$ 6,462	\$ 6,096	\$ 5,498
Operating income	961	1,793	1,659	1,485	1,242
Income from continuing operations after income taxes attributable to PPL	447	907	1,001	825	666
Net income attributable to PPL	407	930	1,288	865	669
<b>Balance Sheet Items - millions (c)</b>					
Total assets	22,165	21,405	19,972	19,747	17,926
Short-term debt	639	679	92	42	214
Long-term debt (d)	7,143	7,838	7,568	7,746	7,081
Long-term debt with affiliate trusts				89	89
Noncontrolling interests	319	319	320	361	107
Common equity	5,496	5,077	5,556	5,122	4,418
Total capitalization (d)	13,597	13,913	13,536	13,360	11,909
Capital lease obligations				10	11
<b>Financial Ratios</b>					
Return on average common equity - %	7.48	16.88	24.47	17.81	15.44
Ratio of earnings to fixed charges - total enterprise basis (e)	2.0	3.2	2.9	2.8	2.3
<b>Common Stock Data</b>					
Number of shares outstanding - Basic - thousands					
Year-end	377,183	374,581	373,271	385,039	380,145
Average	376,082	373,626	380,563	380,754	379,132
Income from continuing operations after income taxes available to PPL common shareowners - Basic EPS					
	\$ 1.18	\$ 2.42	\$ 2.62	\$ 2.16	\$ 1.75
Income from continuing operations after income taxes available to PPL common shareowners - Diluted EPS					
	\$ 1.18	\$ 2.41	\$ 2.60	\$ 2.13	\$ 1.74
Net income available to PPL common shareowners - Basic EPS					
	\$ 1.08	\$ 2.48	\$ 3.37	\$ 2.26	\$ 1.76
Net income available to PPL common shareowners - Diluted EPS					
	\$ 1.08	\$ 2.47	\$ 3.34	\$ 2.24	\$ 1.74
Dividends declared per share of common stock					
	\$ 1.38	\$ 1.34	\$ 1.22	\$ 1.10	\$ 0.96
Book value per share (c)					
	\$ 14.57	\$ 13.55	\$ 14.88	\$ 13.30	\$ 11.62
Market price per share (c)					
	\$ 32.31	\$ 30.69	\$ 52.09	\$ 35.84	\$ 29.40
Dividend payout ratio - % (f)					
	128	54	37	49	55
Dividend yield - % (g)					
	4.27	4.37	2.34	3.07	3.27
Price earnings ratio (f) (g)					
	29.92	12.43	15.60	16.00	16.90
<b>Sales Data - millions of kWh</b>					
Domestic - Electric energy supplied - retail	38,912	40,374	40,074	38,810	39,413
Domestic - Electric energy supplied - wholesale (h)	38,988	42,712	33,515	30,427	31,530
Domestic - Electric energy delivered	36,717	38,058	37,950	36,683	37,358
International - Electric energy delivered (i)	26,358	27,724	31,652	33,352	33,146

- (a) The earnings each year were affected by several items that management considers special. See "Results of Operations - Segment Results" in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" for a description of special items in 2009, 2008 and 2007.
- (b) See "Item 1A. Risk Factors" and Note 14 to the Financial Statements for a discussion of uncertainties that could affect PPL's future financial condition.
- (c) As of each respective year-end.
- (d) The year 2007 excludes amounts related to PPL's natural gas distribution and propane businesses that had been classified as held for sale at December 31, 2007.
- (e) Computed using earnings and fixed charges of PPL and its subsidiaries. Fixed charges consist of interest on short- and long-term debt, amortization of debt discount, expense and premium - net, other interest charges, the estimated interest component of operating rentals and preferred securities distributions of subsidiaries. See Exhibit 12(a) for additional information.
- (f) Based on diluted EPS.
- (g) Based on year-end market prices.
- (h) All years include kWh associated with the Long Island generation business and the majority of PPL Maine's hydroelectric generation business that have been classified as Discontinued Operations.
- (i) Years 2007 and earlier include the deliveries associated with the Latin American businesses, until the dates of their sales in 2007.

**ITEM 6. SELECTED FINANCIAL AND OPERATING DATA**

<b>PPL Electric Utilities Corporation (a)(b)</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
<b>Income Items - millions</b>					
Operating revenues	\$ 3,292	\$ 3,401	\$ 3,410	\$ 3,259	\$ 3,163
Operating income	329	375	350	418	377
Net income	142	176	163	194	147
Income available to PPL	124	158	145	180	145
<b>Balance Sheet Items - millions (c)</b>					
Total assets	5,092	5,416	4,986	5,315	5,537
Short-term debt		95	41	42	42
Long-term debt	1,472	1,769	1,674	1,978	2,411
Shareowners' equity	1,896	1,646	1,586	1,559	1,375
Total capital provided by investors	3,368	3,510	3,301	3,579	3,828
<b>Financial Ratios</b>					
Return on average common equity - %	9.08	12.00	11.35	14.33	11.20
Ratio of earnings to fixed charges (d)	2.8	3.4	2.7	2.9	2.1
Ratio of earnings to combined fixed charges and preferred stock dividends (e)	2.3	2.7	2.3	2.5	2.1
<b>Sales Data</b>					
Customers (thousands) (c)	1,398	1,394	1,387	1,377	1,365
Electric energy delivered - millions of kWh					
Residential	14,256	14,419	14,411	13,714	14,218
Commercial	13,837	13,942	13,801	13,174	13,196
Industrial	8,435	9,508	9,547	9,638	9,777
Other	189	189	191	157	167
	<u>36,717</u>	<u>38,058</u>	<u>37,950</u>	<u>36,683</u>	<u>37,358</u>
Total electric energy delivered					
	<u>36,717</u>	<u>38,058</u>	<u>37,950</u>	<u>36,683</u>	<u>37,358</u>
Electric energy supplied as a PLR - millions of kWh	36,695	38,043	37,919	36,577	36,917

- (a) Earnings for the years 2009, 2007, 2006 and 2005 were affected by several items that management considers special. See "Results of Operations - Earnings" in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" for a description of special items in 2009 and 2007.
- (b) See "Item 1A. Risk Factors" and Note 14 to the Financial Statements for a discussion of uncertainties that could affect PPL Electric's future financial condition.
- (c) As of each respective year-end.
- (d) Computed using earnings and fixed charges of PPL Electric and its subsidiaries. Fixed charges consist of interest on short- and long-term debt, other interest charges, amortization of debt discount, expense and premium - net, and the estimated interest component of operating rentals. See Exhibit 12(c) for additional information.
- (e) Computed using earnings, fixed charges and preferred stock dividend requirements of PPL Electric and its subsidiaries. Fixed charges consist of interest on short- and long-term debt, other interest charges, amortization of debt discount, expense and premium - net, and the estimated interest component of operating rentals. See Exhibit 12(c) for additional information.

## PPL CORPORATION AND SUBSIDIARIES

### Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

#### Overview

PPL is an energy and utility holding company with headquarters in Allentown, Pennsylvania. Refer to "Item 1. Business - Background" for descriptions of its reportable segments, which are Supply, International Delivery and Pennsylvania Delivery. Through its subsidiaries, PPL is primarily engaged in the generation and marketing of electricity in two key markets - the northeastern and western U.S. - and in the delivery of electricity in Pennsylvania and the U.K. PPL's overall strategy is to achieve disciplined growth in energy supply margins while limiting volatility in both cash flows and earnings and to achieve stable, long-term growth in its regulated electricity delivery businesses through efficient operations and strong customer and regulatory relations. More specifically, PPL's strategy for its electricity generation and marketing business is to match energy supply with load, or customer demand, under contracts of varying lengths with creditworthy counterparties to capture profits while effectively managing exposure to energy and fuel price volatility, counterparty credit risk and operational risk. PPL's strategy for its electricity delivery businesses is to own and operate these businesses at the most efficient cost while maintaining high quality customer service and reliability.

PPL faces several risks in its supply business, principally electricity and capacity wholesale price risk, fuel supply and price risk, electricity and fuel basis risk, power plant performance, evolving regulatory frameworks and counterparty credit risk. PPL attempts to manage these risks through various means. For instance, PPL operates a portfolio of generation assets that is diversified as to geography, fuel source, cost structure and operating characteristics. PPL expects to expand its generation capacity over the next several years through power uprates at certain of its existing power plants, and is continually evaluating the potential construction of new plants and the potential acquisition of existing plants or businesses. PPL is and will continue to remain focused on the operating efficiency and availability of its existing and any newly constructed or acquired power plants.

In addition, PPL has executed and continues to pursue contracts of varying lengths for energy sales and fuel supply, while using other means to mitigate risks associated with adverse changes in the difference, or margin, between the cost to produce electricity and the price at which PPL sells it. PPL's future profitability will be affected by prevailing market conditions and whether PPL decides to, or is able to, continue to enter into long-term or intermediate-term power sales and fuel purchase agreements or renew its existing agreements. Currently, PPL's commitments for energy sales are satisfied through its own generation assets and supply purchased from third parties. PPL markets and trades around its physical portfolio of generating assets through integrated generation, marketing and trading functions.

PPL has adopted financial and operational risk management programs that, among other things, are designed to monitor and manage its exposure to earnings and cash flow volatility related to changes in energy and fuel prices, interest rates, foreign currency exchange rates, counterparty credit quality and the operating performance of its generating units.

The principal challenge that PPL faces in its electricity delivery businesses is to maintain high quality customer service and reliability in a cost-effective manner. PPL's electricity delivery businesses are rate-regulated. Accordingly, these businesses are subject to regulatory risk with respect to costs that may not be recovered and investment returns that may not be collected through customer rates. See "Customer Choice - End of Transition Period" below for information on additional risks PPL's domestic electricity business may face.

PPL faces additional financial risks in conducting U.K. operations, such as fluctuations in foreign currency exchange rates and the effect these rates have on the conversion of U.K. earnings and cash flows to U.S. dollars. PPL attempts to manage these financial risks through its risk management programs.

In order to manage financing costs and access to credit markets, a key objective for PPL's business as a whole is to maintain a strong credit profile. PPL continually focuses on maintaining an appropriate capital structure and liquidity position.

See "Item 1A. Risk Factors" for more information concerning these and other material risks PPL faces in its businesses.

In May 2009, PPL Generation signed a definitive agreement to sell its Long Island generation business and related tolling agreements, and expects the sale to close on or about February 26, 2010. In November 2009, PPL Maine completed the sale of the majority of its hydroelectric generation business. These businesses are included in the Supply segment. In 2008, PPL sold its natural gas distribution and propane businesses, which were included in the Pennsylvania Delivery segment. In 2007, PPL sold its regulated electricity delivery businesses in Latin America, which were included in the International Delivery segment. See Note 9 to the Financial Statements for additional information.

The purpose of "Management's Discussion and Analysis of Financial Condition and Results of Operations" is to provide information concerning PPL's performance in implementing the strategies and managing the risks and challenges mentioned above. Specifically:

- "Results of Operations" provides an overview of PPL's operating results in 2009, 2008 and 2007, including a review of earnings, with details of results by reportable segment. It also provides a brief outlook for 2010.
- "Financial Condition - Liquidity and Capital Resources" provides an analysis of PPL's liquidity position and credit profile, including its sources of cash (including bank credit facilities and sources of operating cash flow) and uses of cash (including contractual obligations and capital expenditure requirements) and the key risks and uncertainties that impact PPL's past and future liquidity position and financial condition. This subsection also includes a listing and discussion of PPL's current credit ratings.
- "Financial Condition - Risk Management - Energy Marketing & Trading and Other" provides an explanation of PPL's risk management



programs relating to market risk and credit risk.

- "Application of Critical Accounting Policies" provides an overview of the accounting policies that are particularly important to the results of operations and financial condition of PPL and that require its management to make significant estimates, assumptions and other judgments.

The information provided in this Item 7 should be read in conjunction with PPL's Consolidated Financial Statements and the accompanying Notes.

Terms and abbreviations are explained in the glossary. Dollars are in millions unless otherwise noted.

### **Customer Choice – End of Transition Period**

In 1996, the Customer Choice Act was enacted to restructure Pennsylvania's electric utility industry in order to create retail access to a competitive market for generation of electricity. The Customer Choice Act required each Pennsylvania electric utility, including PPL Electric, to file a restructuring plan to "unbundle" its rates into separate generation, transmission and distribution components and to permit its customers to directly access alternate suppliers of electricity. Under the Customer Choice Act, PPL Electric was required to act as a PLR. As part of a settlement approved by the PUC and in connection with the restructuring plan PPL Electric filed under the Customer Choice Act, PPL Electric agreed to provide electricity as a PLR at predetermined "capped" rates through 2009. In addition, the PUC authorized recovery of approximately \$2.97 billion of competitive transition or "stranded" costs (generation-related costs that might not otherwise be recovered in a competitive market) from customers during an 11-year transition period. For PPL Electric, this transition period ended on December 31, 2009.

As a result of the PUC settlement order and the PLR obligation, PPL Electric, through 2009, generally bore the risk that it would not be able to obtain adequate energy supply at the "capped" rates it could charge to its customers who did not select an alternate electricity supplier. To mitigate this risk, PPL Electric entered into full requirements energy supply agreements with PPL EnergyPlus. Under these agreements, through 2009, PPL EnergyPlus supplied PPL Electric's entire PLR load at predetermined prices equal to the capped generation rates that PPL Electric was authorized to charge its customers.

Related to PPL Electric's transition period, the following has occurred or will occur:

- In August 1999, CTC of \$2.4 billion were converted to intangible transition costs when they were securitized by the issuance of transition bonds. The intangible transition costs were amortized over the life of the transition bonds, through December 2008, in accordance with an amortization schedule filed with the PUC. These transition bonds matured in tranches, with the final tranche being repaid in December 2008.

During the transition period, PPL Electric was authorized by the PUC to bill its customers \$130 million for a portion of the costs associated with decommissioning of the Susquehanna nuclear plant. Under the power supply agreements between PPL Electric and PPL EnergyPlus, these revenues were passed on to PPL EnergyPlus. Similarly, these revenues were passed on to PPL Susquehanna under a power supply agreement between PPL EnergyPlus and PPL Susquehanna and invested in the NDT funds. Effective January 1, 2010, these ratepayer billings have ceased.

- In December 2009, PPL Electric filed with the PUC a final reconciliation of CTC and ITC recoveries during the transition period. At December 31, 2009, PPL Electric has recorded a net regulatory liability of \$33 million related to these recoveries. The net overcollection will be reflected in customer rates in 2010.
- At December 31, 2009, PPL Electric's long-term power purchase agreements with PPL EnergyPlus (effective since 2000 and 2002) expired.
- To mitigate 2010 rate increases, PPL Electric implemented two programs in 2008 and 2009 that allowed customers to make prepayments toward their 2010 and 2011 electric bills or to defer any 2010 electric bill increases exceeding 25%. Any deferred amounts are to be repaid by 2012. At December 31, 2009, PPL Electric has recorded a liability of \$36 million for these programs.
- Effective January 1, 2010, PPL Electric's rates for generation supply as a PLR are no longer capped and the cost of electric generation is based on a competitive solicitation process. During 2007 through 2009, PPL Electric procured through PUC-approved solicitation procedures, the electric generation supply it will need in 2010 for customers who do not choose an alternative supplier. The prices in these contracts will result in an average residential customer paying approximately 30% higher rates, as compared to the previously-capped rates on delivered electricity. PPL Electric is currently procuring the PLR supply it will need for the January 2011 through May 2013 period. The results of all procurements continue to require the approval of the PUC.
- For those customers who choose to procure generation supply from other providers, PPL Electric will provide services for these alternative generation suppliers to bill usage charges, among other duties. As required by a PUC-approved plan, PPL Electric will be purchasing certain receivables from alternative suppliers at a discount.

In October 2008, Act 129 became effective. This law created requirements for energy efficiency and conservation programs and for the use of smart metering technology, imposed new PLR electricity supply procurement rules, provided remedies for market misconduct, and made changes to the existing Alternative Energy Portfolio Standard.

Prior to the expiration of the generation rate caps, customers' interest in purchasing generation supply from other providers was limited because in recent years, the long-term supply agreement between PPL Electric and PPL EnergyPlus provided a below-market cost of generation supply for these customers. As a result, a limited amount of "shopping" occurred. In 2010, several alternative suppliers have offered to provide

generation supply in PPL Electric's service territory. When its customers purchase supply from these alternative suppliers or from PPL Electric as PLR, the purchase of such supply has no significant impact on the operating results of PPL Electric. The cost to purchase PLR supply is passed directly by PPL Electric to its customers without markup. For those customers who receive their supply from an alternative supplier, PPL Electric may act as billing agent or the alternative supplier may bill for their supply directly, and in either case, PPL Electric does not record revenues or expenses related to this supply. PPL Electric remains the distribution provider for all the customers in its service territory and charges a regulated rate for the service of delivering that electricity.

Lower demand for electric power due to increased prices, the economic downturn or the conservation provisions of Act 129 that require PPL Electric to reduce its customers' electricity usage in future periods, could impact future revenues. The reduction in volume could be offset by changes in customer rates for this service, subject to PUC approval, depending on PPL Electric's cost structure. Act 129 includes one-time penalties of up to \$20 million for not attaining the required reductions by 2011 and 2013. At this time, PPL Electric expects to meet these targeted reductions. The costs of complying with the other provisions of Act 129 would, subject to PUC approval, be recoverable through an automatic adjustment clause. None of the above changes are expected to have a significant impact on PPL Electric's 2010 financial condition, operating results or cash flows.

With the expiration of the long-term power purchase agreements between PPL Electric and PPL EnergyPlus, PPL EnergyPlus now has multiple options as to how, and to whom, it sells the electricity produced by PPL Energy Supply's generation plants. These sales are based on prevailing market rates, as compared to pre-determined capped rates under the expired supply agreements with PPL Electric. PPL EnergyPlus has entered into various wholesale and retail contracts to sell this power and at this time has hedged almost 100% of expected 2010 baseload generation output. The expiration of the long-term supply agreements with PPL Electric also provides PPL Energy Supply the ability to adjust its exposure to fluctuations in demand that existed with supplying PPL Electric's PLR load. Entry of new generation suppliers into the Pennsylvania marketplace provides PPL Energy Supply the ability to provide generation supply to additional wholesale customers. Overall, these changes and the resulting level of hedged electricity prices are expected to have a positive impact on the financial condition, operating results and cash flows of PPL Energy Supply.

PPL Electric's customers are no longer funding contributions to Susquehanna's NDT funds. PPL will continue to manage the NDT funds until the PPL Susquehanna plant is decommissioned. If the balance of the NDT funds is not adequate to cover decommissioning costs, PPL Susquehanna will be responsible to fund 90% of the shortfall. The Susquehanna nuclear units currently are licensed to operate until 2042 and 2044.

The final expiration of generation rate caps in Pennsylvania, applicable to three other large regulated utilities, is scheduled to occur at the end of 2010. Discussions concerning generation rate caps and rate increase mitigation are continuing. The final result of those discussions and the future impact on the financial condition and future cash flows of PPL cannot be predicted at this time.

See Note 14 to the Financial Statements for additional information on Pennsylvania legislative and other regulatory activities.

## **Market Events**

In 2008, conditions in the financial markets became disruptive to the processes of managing credit risk, responding to liquidity needs, measuring derivatives and other financial instruments at fair value, and managing market risk. Bank credit capacity was reduced and the cost of renewing or establishing new credit facilities increased, thereby introducing uncertainties as to PPL's ability to enter into long-term energy commitments or reliably estimate the longer-term cost and availability of credit. In general, bank credit capacity has increased from the significantly constrained levels of 2008 and early 2009. In addition, the cost of renewing or establishing new credit facilities has improved when compared with the 2008 and early 2009 periods.

### Commodity Price Risk

The contraction in wholesale energy market liquidity and accompanying decline in wholesale energy prices due to conditions in the financial and commodity markets significantly impacted PPL's earnings during the second half of 2008 and the first half of 2009. See "Statement of Income Analysis - Domestic Gross Energy Margins - Domestic Gross Energy Margins By Region" for further discussion.

### Credit Risk

Credit risk is the risk that PPL would incur a loss as a result of nonperformance by counterparties of their contractual obligations. PPL maintains credit policies and procedures to limit counterparty credit risk. Conditions in the financial and commodity markets have generally increased PPL's exposure to credit risk. See Notes 17 and 18 to the Financial Statements, and "Risk Management - Energy Marketing & Trading and Other - Credit Risk" for more information on credit risk.

### Liquidity Risk

PPL expects to continue to have access to adequate sources of liquidity through operating cash flows, cash and cash equivalents, credit facilities and, from time to time, the issuance of capital market securities. PPL's ability to access capital markets may be impacted by conditions in the overall financial and capital markets, as well as conditions specific to the utility sector. See "Financial Condition - Liquidity and Capital Resources" for an expanded discussion of PPL's liquidity position and a discussion of its forecasted sources of cash.

### Valuations in Inactive Markets

Conditions in the financial markets have generally made it difficult to determine the fair value of certain assets and liabilities in inactive

markets. Management has reviewed the activity in the energy and financial markets in which PPL transacts, concluding that all of these markets were active at December 31, 2009, with the exception of the market for auction rate securities. See Notes 17 and 21 to the Financial Statements and "Financial Condition - Liquidity and Capital Resources - Auction Rate Securities" for a discussion of these investments.

#### Securities Price Risk

Declines in the market price of debt and equity securities result in unrealized losses that reduce the asset values of PPL's investments in its defined benefit plans and NDT funds. Both the defined benefit plans and the NDT funds earned positive returns in the second half of 2009, thereby recovering a portion of the negative returns incurred in 2008 and the first quarter of 2009. PPL actively monitors the performance of the investments held in its defined benefit plans and NDT funds and periodically reviews the funds' investment allocations. See "Financial Condition - Risk Management - Energy Marketing & Trading and Other - NDT Funds - Securities Price Risk" for additional information on securities price risk.

Determination of the funded status of defined benefit plans, contribution requirements and net periodic defined benefit costs for future years are subject to changes in various assumptions, in addition to the actual performance of the assets in the plans. See "Application of Critical Accounting Policies - Defined Benefits" for a discussion of the assumptions and sensitivities regarding those assumptions.

#### The Economic Stimulus Package

The Economic Stimulus Package was intended to stimulate the U.S. economy through federal tax relief, expansion of unemployment benefits and other social stimulus provisions, domestic spending for education, health care and infrastructure, including the energy sector. A portion of the benefits included in the Economic Stimulus Package are offered in the form of loan fee reductions, expanded loan guarantees and secondary market incentives, including delayed recognition for tax purposes of income related to the cancellation of certain types of debt. See "Financial Condition - Liquidity and Capital Resources" for a discussion of the applicability to the purchase of notes by PPL.

Funds from the Economic Stimulus Package have been allocated to various federal agencies, such as the DOE, and provided to state agencies through block grants. The DOE has made awards of the funds for smart grid, efficiency-related and renewable energy programs. The Commonwealth of Pennsylvania has also made awards for funding certain energy projects, including solar projects. As discussed in Note 8 to the Financial Statements, PPL has reconsidered and decided to pursue its Holtwood expansion project in view of the tax incentives and potential loan guarantees for renewable energy projects contained in the Economic Stimulus Package. PPL Energy Supply has applied for DOE loan guarantees for the Holtwood expansion project and, through its subsidiary PPL Montana, for the Rainbow redevelopment project. In addition, in July 2009, PPL Electric proposed to the DOE that the agency provide funding for one-half of a \$38 million smart grid project. The project would use smart grid technology to strengthen reliability, save energy and improve electric service for 60,000 Harrisburg, Pennsylvania area customers. It would also provide benefits beyond the Harrisburg region, helping to speed power restoration across PPL Electric's 29-county service territory. In October 2009, PPL Electric received notification that its grant proposal had been selected by the DOE for award negotiations. PPL Electric cannot predict the outcome of these award negotiations.

### **Results of Operations**

PPL presents tables analyzing changes in amounts between periods within "Segment Results" and "Statement of Income Analysis" on a constant U.K. foreign currency exchange rate basis, where applicable, in order to isolate the impact of the change in the exchange rate on the item being explained. Results computed on a constant U.K. foreign currency exchange rate basis are calculated by translating current year results at the prior year weighted-average foreign currency exchange rate.

#### **Earnings**

Net income attributable to PPL and the related EPS were:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Net income attributable to PPL	\$ 407	\$ 930	\$ 1,288
EPS - basic	\$ 1.08	\$ 2.48	\$ 3.37
EPS - diluted	\$ 1.08	\$ 2.47	\$ 3.34

The changes in net income attributable to PPL from year to year were, in part, due to several special items that management considers significant. Details of these special items are provided within the review of each segment's earnings.

The year-to-year changes in significant earnings components, including domestic gross energy margins by region and significant income statement line items, are explained in the "Statement of Income Analysis."

PPL's earnings beyond 2009 are subject to various risks and uncertainties. See "Forward-Looking Information," "Item 1A. Risk Factors," the rest of this Item 7 and Note 14 to the Financial Statements for a discussion of the risks, uncertainties and factors that may impact PPL's future earnings.

#### **Segment Results**

Net income attributable to PPL by segment was:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Supply	\$ 40	\$ 479	\$ 568
International Delivery	243	290	610
Pennsylvania Delivery	124	161	110
Total	<u>\$ 407</u>	<u>\$ 930</u>	<u>\$ 1,288</u>

### Supply Segment

The Supply segment primarily consists of the domestic energy marketing and trading activities, as well as the generation and development operations of PPL Energy Supply. In December 2009, PPL Maine sold its 8.33% ownership interest in Wyman Unit 4. In November 2009, PPL Maine completed the sale of the majority of its hydroelectric generation business. In May 2009, PPL Generation signed a definitive agreement to sell its Long Island generation business and expects the sale to close on or about February 26, 2010. In August 2007, PPL completed the sale of its domestic telecommunication operations. See Notes 8 and 9 to the Financial Statements for additional information.

The Supply segment results reflect the classification of the Long Island generation business, the majority of the Maine hydroelectric generation business, and the 8.33% ownership interest in Wyman Unit 4, as Discontinued Operations. See Note 9 to the Financial Statements for additional information.

Supply segment net income attributable to PPL was:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Energy revenues			
External (a)	\$ 3,227	\$ 3,371	\$ 1,576
Intersegment	1,806	1,826	1,810
Energy-related businesses	391	486	732
Total operating revenues	<u>5,424</u>	<u>5,683</u>	<u>4,118</u>
Fuel and energy purchases			
External (a)	3,608	3,108	1,419
Intersegment	70	108	156
Other operation and maintenance	867	827	707
Depreciation	226	193	163
Taxes, other than income	29	19	31
Energy-related businesses	380	467	745
Total operating expenses	<u>5,180</u>	<u>4,722</u>	<u>3,221</u>
Other Income - net	50	24	40
Other-Than-Temporary Impairments	18	36	3
Interest Expense	191	200	154
Income Taxes	31	283	221
Income (Loss) from Discontinued Operations	<u>(13)</u>	<u>15</u>	<u>12</u>
Net Income	41	481	571
Net Income Attributable to Noncontrolling Interests	1	2	3
Net Income Attributable to PPL	<u>\$ 40</u>	<u>\$ 479</u>	<u>\$ 568</u>

(a) Includes impact from energy-related economic activity. See "Commodity Price Risk (Non-trading) - Economic Activity" in Note 18 to the Financial Statements for additional information.

The after-tax changes in net income attributable to PPL between these periods were due to the following factors.

	<u>2009 vs. 2008</u>	<u>2008 vs. 2007</u>
Eastern U.S. non-trading margins	\$ (3)	\$ (62)
Western U.S. non-trading margins	20	5
Net energy trading margins	81	(95)
Energy-related businesses	(3)	(4)
Other operation and maintenance	(30)	18
Depreciation	(19)	(18)
Taxes, other than income	(6)	7
Other income - net	9	(8)
Interest expense	5	(28)
Income taxes	(16)	(61)
Discontinued operations (Note 9)	(9)	3
Other	1	2

Special items	(469)	152
	<u>\$ (439)</u>	<u>\$ (89)</u>

- See "Domestic Gross Energy Margins" for an explanation of non-trading margins and net energy trading margins.
- Other operation and maintenance expenses increased in 2009 compared with 2008, primarily due to increased payroll-related costs, higher contractor-related costs and other costs at PPL's generation plants.

Other operation and maintenance expenses decreased in 2008 compared with 2007, primarily due to lower costs at PPL's nuclear power plants and lower defined benefit costs.

- Depreciation expense increased in 2009 compared with 2008, primarily due to the scrubbers at Brunner Island and Montour and the portions of the Susquehanna uprate projects that were placed in service in 2008 and 2009.

Depreciation expense increased in 2008 compared with 2007, primarily due to the Montour scrubbers and the Susquehanna uprate project that were placed in service in 2008.

- Interest expense increased in 2008 compared with 2007, primarily due to increased interest on long-term debt resulting from new issuances, partially offset by hedging activities.
- Income taxes increased in 2009 compared with 2008, in part due to lower domestic manufacturing deductions in 2009.

Income taxes increased in 2008 compared with 2007, primarily due to the loss of synfuel tax credits as the projects ceased operation at the end of 2007.

- Special items decreased in 2009 compared with 2008, primarily due to a \$476 million after-tax change in energy-related economic activity. The change is primarily the result of certain power and gas cash flow hedges failing hedge effectiveness testing in the third and fourth quarters of 2008, as well as the first quarter of 2009. Hedge accounting is not permitted for the quarter in which this occurs and, accordingly, the entire change in fair value for the periods that failed was recorded to the income statement. However, these transactions were not redesignated as hedges, as prospective regression analysis demonstrated that these hedges are expected to be highly effective over their term. For 2008, an after-tax gain of \$298 million was recognized in earnings as a result of these hedge failures. During the second, third and fourth quarters of 2009, fewer power and gas cash flow hedges failed hedge effectiveness testing; therefore, a portion of the previously recognized unrealized gains recorded in the second half of 2008 and the first quarter of 2009 associated with these hedges were reversed. For 2009, after-tax losses of \$215 million were recognized in earnings.

The following after-tax amounts, which management considers special items, also impacted the Supply segment's earnings.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Energy-related economic activity (Note 18)	\$ (225)	\$ 251	\$ 32
Sales of assets			
Long Island generation business (a)	(33)		
Interest in Wyman Unit 4 (Note 9)	(4)		
Majority of Maine hydroelectric generation business (Note 9)	22		
Domestic telecommunication operations (Note 8)			(23)
Impairments			
Impacts from emission allowances (b)	(19)	(25)	
Other asset impairments (c)	(4)	(15)	
Adjustments - NDT investments (d)		(17)	
Transmission rights (e)			(13)
Workforce reduction (Note 12)	(6)	(1)	(4)
Other			
Change in tax accounting method related to repairs (Note 5)	(21)		
Montana hydroelectric litigation (Note 14)	(3)		
Synthetic fuel tax adjustment (Note 14)		(13)	
Montana basin seepage litigation (Note 14)		(5)	
Off-site remediation of ash basin leak (Note 14)		1	
Settlement of Wallingford cost-based rates (f)			33
PJM billing dispute			(1)
Total	<u>\$ (293)</u>	<u>\$ 176</u>	<u>\$ 24</u>

- (a) Consists primarily of the initial impairment charge recorded in June 2009 when this business was classified as held for sale. See Note 9 to the Financial Statements for additional information on the anticipated sale.
- (c) 2009 primarily consists of a pre-tax charge of \$37 million related to sulfur dioxide emission allowances. See Note 17 to the Financial Statements for additional information.

2008 consists of charges related to annual nitrogen oxide allowances and put options. See Note 14 to the Financial Statements for

additional information.

- (c) 2008 primarily consists of a pre-tax charge of \$22 million related to the cancellation of the Holtwood hydroelectric expansion project. See Note 8 to the Financial Statements for additional information.
- (d) Represents other-than-temporary impairment charges on securities, including reversals of previous impairments when previously impaired securities were sold.
- (e) See "Other Operation and Maintenance" for more information on the \$23 million pre-tax impairment recorded in 2007.
- (f) In 2003, PPL Wallingford and PPL EnergyPlus sought from the FERC cost-based payments based upon the RMR status of four units at the Wallingford, Connecticut generating facility. In 2007, as a result of a settlement agreement, PPL recognized \$55 million of revenue and \$4 million of interest income.

#### 2010 Outlook

Excluding special items, PPL projects higher earnings from its Supply segment in 2010 compared with 2009, due to growth in energy margins. The forecast for growth in energy margins is based on hedged power and fuel prices as well as established capacity prices in PJM. These positive factors are expected to be partially offset by higher depreciation, financing costs and operation and maintenance expenses.

#### International Delivery Segment

The International Delivery segment consists primarily of the electricity distribution operations in the U.K. In 2007, PPL completed the sale of its Latin American businesses. In 2008, the International Delivery segment recognized income tax benefits and miscellaneous expenses in Discontinued Operations in connection with the dissolution of certain Latin American holding companies. In 2009, the International Delivery segment recognized \$24 million of income tax expense in Discontinued Operations related to a correction of the calculation of tax bases of the Latin American businesses sold in 2007. See Note 9 to the Financial Statements for additional information.

The International Delivery segment results reflect the classification of its Latin American businesses as Discontinued Operations.

International Delivery segment net income attributable to PPL was:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Utility revenues	\$ 684	\$ 824	\$ 863
Energy-related businesses	32	33	37
Total operating revenues	<u>716</u>	<u>857</u>	<u>900</u>
Other operation and maintenance	140	186	252
Depreciation	115	134	147
Taxes, other than income	57	66	67
Energy-related businesses	16	14	17
Total operating expenses	<u>328</u>	<u>400</u>	<u>483</u>
Other Income - net	(11)	17	26
Interest Expense	87	144	183
Income Taxes	20	45	(43)
Income (Loss) from Discontinued Operations	<u>(27)</u>	<u>5</u>	<u>313</u>
Net Income	243	290	616
Net Income Attributable to Noncontrolling Interests			6
Net Income Attributable to PPL	<u>\$ 243</u>	<u>\$ 290</u>	<u>\$ 610</u>

The after-tax changes in net income attributable to PPL between these periods were due to the following factors.

	<u>2009 vs. 2008</u>	<u>2008 vs. 2007</u>
U.K.		
Delivery margins	\$ 17	\$ 12
Other operating expenses	7	22
Other income - net	(4)	(7)
Depreciation	(4)	4
Interest expense	28	5
Income taxes	24	24
Foreign currency exchange rates	(69)	(14)
Gain on transfer of equity investment		(5)
Other	(4)	(3)
Discontinued Operations (Note 9)	(5)	(49)
U.S. interest expense		17
U.S. income taxes	1	(32)
Gain (loss) on economic hedges (Note 15)	(12)	10
Other	2	6
Special items	<u>(28)</u>	<u>(310)</u>
	<u>\$ (47)</u>	<u>\$ (320)</u>

- Lower U.K. other operating expenses in 2008 compared with 2007, were primarily due to lower compensation and lower pension costs.
- Lower U.K. interest expense in 2009 compared with 2008, was primarily due to lower inflation rates on U.K. Index-linked Senior Unsecured Notes and lower debt balances.
- Lower U.K. income taxes in 2009 compared with 2008, were primarily due to HMRC's determination related to the valuation of a business activity sold in 1999 and to the deductibility of foreign currency exchange losses, partially offset by the items in 2008 mentioned below.

Lower U.K. income taxes in 2008 compared with 2007, were primarily due to HMRC's determination related to deductibility of imputed interest on a loan from Hyder and a change in tax law that included the phase-out of tax depreciation on industrial buildings over a four-year period.

- Changes in foreign currency exchange rates negatively impacted U.K. earnings for both periods. The weighted-average exchange rates for the British pound sterling were approximately \$1.53 in 2009, \$1.91 in 2008 and \$2.00 in 2007.
- Higher U.S. income taxes in 2008 compared with 2007, was primarily due to the change in a U.S. income tax reserve resulting from the lapse in 2007 of an applicable statute of limitations.

The following after-tax amounts, which management considers special items, also impacted the International Delivery segment's earnings.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Foreign currency-related economic hedges - unrealized impacts (Note 18)	\$ 1		
Sales of assets			
Latin American businesses (Note 9)	(27)		\$ 259
Impairments	(1)		
Workforce reduction (Note 12)	(2)	\$ (1)	(4)
Other			
Change in U.K. tax rate (Note 5)			54
Total	<u>\$ (29)</u>	<u>\$ (1)</u>	<u>\$ 309</u>

#### 110 Outlook

Excluding special items, PPL projects lower earnings from its International Delivery segment in 2010 compared with 2009, as a result of higher income taxes, higher operation and maintenance expenses and higher financing costs. These negative factors are expected to be partially offset by higher electricity delivery margins and a more favorable currency exchange rate.

In December 2009, Ofgem completed its rate review for the five-year period from April 1, 2010 through March 31, 2015. Ofgem allowed WPD an average increase in total revenues, before inflationary adjustments, of 6.9% in each of the five years. The revenue increase includes reimbursement to electricity distributors for higher operating and capital costs to be incurred. Also, Ofgem set the weighted average cost of capital at 4.7%, which includes pre-tax debt and post-tax equity costs and excludes adjustments for inflation, for all distribution companies. This is a 0.8% decrease from the previous regulatory period. Additionally, Ofgem has established strong incentive mechanisms to provide companies significant opportunities to enhance overall returns by improving network efficiency, reliability or customer service.

#### Pennsylvania Delivery Segment

The Pennsylvania Delivery segment includes the regulated electric delivery operations of PPL Electric. In October 2008, PPL sold its natural gas distribution and propane businesses. See Note 9 to the Financial Statements for additional information.

The Pennsylvania Delivery segment results in 2008 and 2007 reflect the classification of PPL's natural gas distribution and propane businesses' as Discontinued Operations.

Pennsylvania Delivery segment net income attributable to PPL was:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Operating revenues			
External	\$ 3,222	\$ 3,293	\$ 3,254
Intersegment	70	108	156
Total operating revenues	<u>3,292</u>	<u>3,401</u>	<u>3,410</u>
Fuel and energy purchases			
External	114	163	207
Intersegment	1,806	1,826	1,810
Other operation and maintenance	417	410	406
Amortization of recoverable transition costs	304	293	310

Depreciation	128	131	132
Taxes, other than income	194	203	200
Total operating expenses	<u>2,963</u>	<u>3,026</u>	<u>3,065</u>
Other Income - net	10	14	31
Interest Expense	118	111	135
Income Taxes	79	102	81
Income (Loss) from Discontinued Operations		3	(32)
Net Income	<u>142</u>	<u>179</u>	<u>128</u>
Net Income Attributable to Noncontrolling Interests	<u>18</u>	<u>18</u>	<u>18</u>
Net Income Attributable to PPL	<u>\$ 124</u>	<u>\$ 161</u>	<u>\$ 110</u>

The after-tax changes in net income attributable to PPL between these periods were due to the following factors.

	<u>2009 vs. 2008</u>	<u>2008 vs. 2007</u>
Delivery revenues (net of CTC/ITC amortization, interest expense on transition bonds and ancillary charges)	\$ (16)	\$ 32
Other operation and maintenance	3	(5)
Other income - net	(2)	(10)
Interest expense	(12)	1
Discontinued operations (Note 9)	(9)	(3)
Other	2	(3)
Special items	(3)	39
	<u>\$ (37)</u>	<u>\$ 51</u>

- Delivery revenues decreased in 2009 compared with 2008, primarily due to unfavorable economic conditions, including industrial customers scaling back on production and the unfavorable impact of weather on sales volumes. See "Revenue Recognition" in Note 1 to the Financial Statements for information on a true-up of FERC formula-based transmission revenues.

Delivery revenues increased in 2008 compared with 2007, primarily due to a base rate increase effective January 1, 2008 and normal load growth.

Other operation and maintenance expenses increased in 2008 compared with 2007, primarily due to insurance recovery of storm costs in 2007, higher vegetation management costs and higher regulatory asset amortization.

- Other income - net decreased in 2008 compared with 2007, primarily due to a decrease in intersegment interest income resulting from a decrease in the average balance outstanding on a note receivable and a lower average floating interest rate.
- Interest expense increased in 2009 compared with 2008, primarily due to \$400 million of debt issuances in October 2008 that prefunded a portion of August 2009 debt maturities.

The following after-tax amounts, which management considers special items, also impacted the Pennsylvania Delivery segment's earnings.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Sales of assets			
Gas and propane businesses (Note 9)		\$ (6)	\$ (44)
Impairments	\$ (1)		
Workforce reduction (a)	(5)		(1)
Other			
Change in tax accounting method related to repairs (Note 5)	(3)		
Total	<u>\$ (9)</u>	<u>\$ (6)</u>	<u>\$ (45)</u>

(a) See Note 12 to the Financial Statements for additional information related to the 2009 workforce reduction.

#### 2010 Outlook

Excluding special items, PPL projects lower earnings from its Pennsylvania Delivery segment in 2010 compared with 2009, as a net result of lower distribution revenues, primarily due to continued slow economic growth and weak customer demand; higher operation and maintenance expenses; offset by lower financing costs.

In late March 2010, PPL Electric expects to file a request with the PUC seeking an increase in its distribution rates beginning in January 2011.

See Note 14 to the Financial Statements for a discussion of items that could impact future earnings, including Pennsylvania legislative and other regulatory activities.



Statement of Income Analysis --

Domestic Gross Energy Margins

Non-GAAP Financial Measure

The following discussion includes financial information prepared in accordance with GAAP, as well as a non-GAAP financial measure, "Domestic Gross Energy Margins." The presentation of "Domestic Gross Energy Margins" is intended to supplement the investor's understanding of PPL's domestic non-trading and trading activities by combining applicable income statement line items and related adjustments to calculate a single financial measure. PPL believes that "Domestic Gross Energy Margins" are useful and meaningful to investors because they provide them with the results of PPL's domestic non-trading and trading activities as another criterion in making their investment decisions. PPL's management also uses "Domestic Gross Energy Margins" in measuring certain corporate performance goals used in determining variable compensation. Other companies may use different measures to present the results of their non-trading and trading activities. Additionally, "Domestic Gross Energy Margins" are not intended to replace "Operating Income," which is determined in accordance with GAAP, as an indicator of overall operating performance. The following table provides a reconciliation between "Operating Income" and "Domestic Gross Energy Margins" as defined by PPL.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Operating Income (a)	\$ 961	\$ 1,793	\$ 1,659
Adjustments:			
Energy-related businesses, net (b)	(27)	(38)	(7)
Other operation and maintenance (a)	1,424	1,423	1,365
Amortization of recoverable transition costs (a)	304	293	310
Depreciation (a)	469	458	442
Taxes, other than income (a)	280	288	298
Revenue adjustments (c)	(1,705)	(3,219)	(1,981)
Expense adjustments (c)	25	566	(262)
Domestic gross energy margins	<u>\$ 1,731</u>	<u>\$ 1,564</u>	<u>\$ 1,824</u>

(a) As reported on the Statements of Income.

(b) Amount represents the net of "Energy-related businesses" revenue and expense as reported on the Statements of Income.

(c) The components of these adjustments are detailed in the tables below.

The following tables provide the income statement line items and other adjustments that comprise domestic gross energy margins.

	<u>2009</u>	<u>2008</u>	<u>Change</u>
Revenue			
Utility (a)	\$ 3,902	\$ 4,114	\$ (212)
Unregulated retail electric and gas (a)	152	151	1
Wholesale energy marketing (a)	3,062	3,344	(282)
Net energy trading margins (a)	17	(121)	138
Revenue adjustments (b)			
WPD utility revenue	(684)	(824)	140
Domestic delivery component of utility revenue	(1,265)	(1,325)	60
Other utility revenue	(61)	(52)	(9)
Impact from energy-related economic activity (c)	274	(1,061)	1,335
Gains from sale of emission allowances (d)	2	6	(4)
Revenues from Supply segment discontinued operations (e)	29	37	(8)
Total revenue adjustments	<u>(1,705)</u>	<u>(3,219)</u>	<u>1,514</u>
	<u>5,428</u>	<u>4,269</u>	<u>1,159</u>
Expense			
Fuel (a)	931	1,084	(153)
Energy purchases (a)	2,791	2,187	604
Expense adjustments (b)			
Impact from energy-related economic activity (c)	(109)	(632)	523
Domestic electric ancillaries (f)	(43)	(54)	11
Gross receipts tax (g)	112	113	(1)
Other	15	7	8
Total expense adjustments	<u>(25)</u>	<u>(566)</u>	<u>541</u>
	<u>3,697</u>	<u>2,705</u>	<u>992</u>
Domestic gross energy margins	<u>\$ 1,731</u>	<u>\$ 1,564</u>	<u>\$ 167</u>

	<u>2008</u>	<u>2007</u>	<u>Change</u>
Revenue			

Utility (a)	\$	4,114	\$	4,114		
Unregulated retail electric and gas (a)		151		102	\$	49
Wholesale energy marketing (a)		3,344		1,436		1,908
Net energy trading margins (a)		(121)		41		(162)
Revenue adjustments (b)						
WPD utility revenue		(824)		(863)		39
Domestic delivery component of utility revenue		(1,325)		(1,308)		(17)
Other utility revenue		(52)		(48)		(4)
RMR revenues				(52)		52
Impact from energy-related economic activity (c)		(1,061)		145		(1,206)
Gains from sale of emission allowances (d)		6		109		(103)
Revenues from Supply segment discontinued operations (e)		37		36		1
Total revenue adjustments		<u>(3,219)</u>		<u>(1,981)</u>		<u>(1,238)</u>
		<u>4,269</u>		<u>3,712</u>		<u>557</u>
Expense						
Fuel (a)		1,084		890		194
Energy purchases (a)		2,187		736		1,451
Expense adjustments (b)						
Impact from energy-related economic activity (c)		(632)		200		(832)
Domestic electric ancillaries (f)		(54)		(50)		(4)
Gross receipts tax (g)		113		112		1
Other		7				7
Total expense adjustments		<u>(566)</u>		<u>262</u>		<u>(828)</u>
		<u>2,705</u>		<u>1,888</u>		<u>817</u>
Domestic gross energy margins	\$	<u>1,564</u>	\$	<u>1,824</u>	\$	<u>(260)</u>

- (a) As reported on the Statements of Income.
- (b) To include/exclude the impact of any revenues and expenses not associated with domestic gross energy margins, consistent with the way management reviews domestic gross energy margins internally.
- (c) See Note 18 to the Financial Statements for additional information regarding economic activity.
- (d) Included in "Other operation and maintenance" on the Statements of Income.
- (e) Represents revenues associated with the Long Island generation business and the majority of the Maine hydroelectric generation business. See Note 9 to the Financial Statements for additional information.
- (f) Included in "Energy purchases" on the Statements of Income.
- (g) Included in "Taxes, other than income" on the Statements of Income.

#### Domestic Gross Energy Margins By Region

Domestic gross energy margins are generated through PPL's non-trading and trading activities. PPL manages its non-trading energy business on a geographic basis that is aligned with its generation assets.

	<u>2009</u>	<u>2008</u>	<u>Change</u>
Non-trading			
Eastern U.S.	\$ 1,391	\$ 1,396	\$ (5)
Western U.S.	323	289	34
Net energy trading	<u>17</u>	<u>(121)</u>	<u>138</u>
Domestic gross energy margins	<u>\$ 1,731</u>	<u>\$ 1,564</u>	<u>\$ 167</u>
	<u>2008</u>	<u>2007</u>	<u>Change</u>
Non-trading			
Eastern U.S.	\$ 1,396	\$ 1,502	\$ (106)
Western U.S.	289	281	8
Net energy trading	<u>(121)</u>	<u>41</u>	<u>(162)</u>
Domestic gross energy margins	<u>\$ 1,564</u>	<u>\$ 1,824</u>	<u>\$ (260)</u>

#### *Eastern U.S.*

Eastern U.S. non-trading margins were \$5 million lower in 2009 compared with 2008. This decrease was primarily due to lower margins on full-requirement sales contracts resulting from mild weather, decreased demand, and customer migration. Also contributing to the decrease were higher average baseload generation fuel costs of 7%, primarily due to higher coal prices. Partially offsetting these lower margins were net gains resulting from the settlement of economic positions associated with rebalancing PPL's portfolios to better align them with current strategies, higher capacity revenue, higher baseload generation output due to unplanned major outages in 2008, and a 2.2% increase in the PLR sales prices in accordance with the PUC Final Order.

Eastern U.S. non-trading margins were \$106 million lower in 2008 compared with 2007. This decrease was primarily due to higher fuel costs, up 16%, primarily due to higher coal prices. Also contributing to the decrease was lower baseload generation, down 4%, primarily due to the

unplanned outages at the eastern coal-fired units and retirement of the Martins Creek coal-fired units in September 2007. Partially offsetting these lower margins were higher margins from the hedged sale of generation in the wholesale market and a 1.4% increase in PLR sales prices in accordance with the PUC Final Order.

#### *Western U.S.*

Western U.S. non-trading margins were \$34 million higher in 2009 compared with 2008. This increase was primarily due to higher wholesale volumes of 6% and increased generation from the hydroelectric units of 5%.

Western U.S. non-trading margins were \$8 million higher in 2008 compared with 2007. This increase was primarily due to increased generation from the hydroelectric units of 2%.

#### *Net Energy Trading*

PPL enters into energy contracts to take advantage of market opportunities. As a result, PPL may at times create a net open position in its portfolio that could result in significant losses if prices do not move in the manner or direction anticipated. However, these trading activities are subject to risk management program limits that are designed to protect PPL from undue financial loss. The margins from these trading activities are reflected in the Statements of Income as "Net energy trading margins." These physical and financial contracts cover trading activity associated with electricity, emission allowances, uranium, FTRs, natural gas, and oil.

Net energy trading margins increased by \$138 million in 2009 compared with 2008. This increase consisted of \$215 million of higher unrealized margins partially offset by \$77 million of lower realized margins. These changes were primarily due to increased margins in the power, gas and oil trading positions resulting from unrealized trading losses in 2008 due to a dramatic decline in energy prices and a severe contraction of liquidity in the wholesale power markets.

Net energy trading margins decreased by \$162 million in 2008 compared with 2007. This decrease consists of \$135 million of lower unrealized margins and \$27 million of lower realized margins, both driven by significant decreases in power and gas prices in the second half of 2008.

#### **Utility Revenues**

The changes in utility revenues were attributable to:

	<u>2009 vs. 2008</u>	<u>2008 vs. 2007</u>
Domestic:		
Retail electric revenue (PPL Electric)		
Delivery	\$ (60)	\$ 17
PLR	(21)	19
Other	9	3
U.K.:		
Foreign currency exchange rates	(154)	(42)
Electric delivery revenue	14	3
	<u>\$ (212)</u>	<u>\$</u>

The decreases in utility revenues for 2009 compared with 2008, excluding foreign currency exchange rate impacts, were primarily due to:

- lower domestic retail electric revenues, attributable to unfavorable economic conditions, including industrial customers scaling back on production. In addition, weather had an unfavorable impact on sales volumes. These decreases were partially offset by favorable price increases. See "Revenue Recognition" in Note 1 to the Financial Statements for information on a true-up of FERC formula-based transmission revenues.
- higher U.K. electric delivery revenues, attributable primarily to an increase in prices effective April 1, a revised estimate of network electricity losses, and favorable changes in customer mix. These increases were partially offset by lower volumes due to unfavorable economic conditions, including industrial customers scaling back on production, and a decrease in engineering and metering services performed for third parties.

The increases in utility revenues for 2008 compared with 2007, excluding foreign currency exchange rate impacts, were primarily due to higher PLR revenue, attributable to normal load growth and a favorable price increase, and higher domestic delivery revenue, primarily due to a base rate increase effective January 1, 2008, as well as normal load growth. These increases were partially offset by the unfavorable impact of weather on residential and commercial sales in 2008.

#### **Energy-related Businesses**

Energy-related businesses contributed \$11 million less to operating income in 2009 compared with 2008. The decrease was primarily attributable to:

- contributions from domestic energy services-related businesses decreasing by \$7 million, primarily due to a decline in construction activity

- caused by the slowdown in the economy; and
- contributions from U.K. energy-related businesses decreasing by \$4 million, primarily due to changes in foreign currency exchange rates.

Energy-related businesses contributed \$31 million more to operating income in 2008 compared with 2007. The increase was primarily attributable to:

- a \$39 million impairment in 2007 of domestic telecommunication operations that were sold in 2007; and
- an \$11 million increase in contributions from domestic energy services-related businesses mainly due to increased construction activity; partially offset by
- \$11 million of lower pre-tax contributions from synfuel projects. This reflects a \$77 million net gain recorded in 2007 on options purchased to hedge the risk associated with the phase-out of synthetic fuel tax credits. This decrease was partially offset by \$66 million less in operating losses from synfuel projects as the projects ceased operation at the end of 2007; and
- \$5 million less in contributions from the domestic telecommunication operations sold in 2007.

See Note 8 to the Financial Statements for additional information on the sale of domestic telecommunications assets. See Note 14 to the Financial Statements for additional information on the shutdown of the synfuel facilities in 2007.

### Other Operation and Maintenance

The increases in other operation and maintenance expenses were due to:

	<u>2009 vs. 2008</u>	<u>2008 vs. 2007</u>
Payroll-related costs	\$ 29	\$ 2
Defined benefit costs - U.S. (Note 12)	18	(7)
Domestic and international workforce reductions (Note 12)	18	(7)
WPD distribution costs	15	7
Montana hydroelectric litigation (Note 14)	8	1
Other costs at fossil/hydroelectric stations	7	1
Other nuclear related expenses	7	(10)
Lower gains on sales of emission allowances	4	103
Impairment of transmission rights (a)		(23)
Contractor-related expenses		(15)
U.K. foreign currency exchange rates	(24)	(8)
Impairment of cancelled generation expansion project in 2008 (Note 8)	(22)	22
Defined benefit costs - U.K. (Note 12)	(16)	(28)
PUC-reportable storm costs	(11)	(4)
WPD recoverable engineering services	(9)	(17)
Impairment and other charges - emission allowances (Notes 14 and 17)	(9)	42
Montana basin seepage litigation (Note 14)	(8)	8
WPD meter operator expenses	(7)	(6)
Other - Domestic	6	
Other - U.K.	(5)	(3)
	<u>\$ 1</u>	<u>\$ 58</u>

- (a) In 2007, Maine Electric Power Company (MEPCO), ISO New England and other New England transmission owners submitted a filing to the FERC seeking to roll the revenue requirement of the MEPCO transmission facilities into the regional transmission rates in New England and to change certain rules concerning the use of the transmission line for energy and capacity. PPL protested this proposal and recorded an impairment of the transmission rights based on their estimated fair value.

### Amortization of Recoverable Transition Costs

Amortization of recoverable transition costs increased by \$11 million in 2009 compared with 2008 and decreased by \$17 million in 2008 compared with 2007. The amortization of recoverable transition costs was based on a PUC amortization schedule, adjusted for ITC and CTC recoveries in customer rates and related expenses. Since the amortization substantially matches the revenue recorded based on recovery in customer rates, there is minimal impact on earnings. At the end of 2009, PPL's recoverable transition costs have been fully amortized.

### Depreciation

Increases in depreciation expense were due to:

	<u>2009 vs. 2008</u>	<u>2008 vs. 2007</u>
Additions to PP&E (a)	\$ 43	\$ 39
U.K. foreign currency exchange rates	(25)	(7)
Extension of useful lives of certain WPD network assets in mid-2007 (Note 1)		(13)
Other	(7)	(3)

(a) Primarily attributable to the completion of the Susquehanna generation uprate and the Montour scrubber projects in 2008 and the Brunner Island scrubber projects in 2009.

**Taxes, Other Than Income**

The decreases in taxes, other than income were due to:

	<b>2009 vs. 2008</b>	<b>2008 vs. 2007</b>
U.K. foreign currency exchange rates	\$ (12)	\$ (3)
Pennsylvania gross receipts tax (a)	(12)	6
Domestic property tax expense (b)	10	(8)
Domestic sales and use tax	4	(4)
Other	2	(1)
	\$ (8)	\$ (10)

(a) The decrease in 2009 compared with 2008 was primarily due to a decrease in the tax rate in 2009. The increase in 2008 compared with 2007 was primarily due to an increase in the tax rate in 2008. Gross receipts tax is passed through to customers.

(b) The change in both periods was primarily due to a \$7 million property tax credit recorded by PPL Montana in 2008.

**Other Income - net**

See Note 16 to the Financial Statements for details of other income.

**Other-Than-Temporary Impairments**

Other-than-temporary impairments decreased by \$18 million in 2009 compared with 2008, primarily due to stronger investment returns caused by improved market conditions within the financial markets.

Other-than-temporary impairments increased by \$33 million in 2008 compared with 2007, primarily due to negative investment returns caused by the downturn in the financial markets in 2008.

**Interest Expense**

The decreases in interest expense were due to:

	<b>2009 vs. 2008</b>	<b>2008 vs. 2007</b>
Hedging activities	\$ (30)	\$ (28)
Inflation adjustment on U.K. Index-linked Senior Unsecured Notes	(29)	6
U.K. foreign currency exchange rates	(17)	(8)
Repayment of transition bonds	(13)	(22)
Capitalized interest	13	(1)
Short-term debt interest expense	6	7
Long-term debt interest expense	4	28
Amortization of debt issuance costs	3	5
Other	4	(4)
	\$ (59)	\$ (17)

**Income Taxes**

The changes in income taxes were due to:

	<b>2009 vs. 2008</b>	<b>2008 vs. 2007</b>
Higher (lower) pre-tax book income	\$ (298)	\$ 32
Tax on foreign earnings (a)	(43)	(3)
Synthetic fuel and other tax credits (b)	(17)	72
Valuation allowance adjustments	(13)	
Tax return adjustments (c)	40	(8)
Domestic manufacturing deduction	13	(2)
U.K. Finance Act adjustments (d)	8	46
Tax reserve adjustments (a) (c) (e)	1	44
Other	9	(10)
	\$ (298)	\$ 172

- (a) During 2009, WPD recorded a \$46 million foreign tax benefit (and a full tax reserve reflected in "Tax reserve adjustments") related to losses generated by restructuring.
  - ) The Section 29/45K synthetic fuel tax credits expired at the end of 2007. During 2008, PPL recorded a \$13 million adjustment to its estimated 2007 fuel tax credits as a result of the IRS publishing the final 2007 inflation-adjusted credit in April 2008.
- (c) During 2009, PPL received consent from the IRS to change its method of accounting for certain expenditures for tax purposes. PPL deducted the resulting IRC Sec. 481 adjustment on its 2008 tax return and recorded a \$24 million adjustment to federal and state income tax expense, which results from the reduction of federal income tax benefits, related to the domestic manufacturing deduction and a reduction of certain state tax benefits related to state net operating losses and regulated depreciation. During 2008, WPD recorded tax benefits of approximately \$17 million from tax return adjustments that were fully reserved.
- (d) The U.K.'s Finance Act of 2008, enacted in July 2008, included a phase-out of tax depreciation on certain buildings. As a result, WPD recorded an \$8 million deferred tax benefit during 2008 related to the reduction in its deferred tax liabilities.

The U.K.'s Finance Act of 2007, enacted in July 2007, included a reduction in the U.K.'s statutory income tax rate. Effective April 1, 2008, the statutory income tax rate was reduced from 30% to 28%. As a result, WPD recorded a \$54 million deferred tax benefit during 2007 related to the reduction in its deferred tax liabilities.

- (e) PPL recorded an \$8 million and \$35 million benefit in 2008 and 2007 as a result of the expiration of applicable statutes of limitations. Additionally, PPL recorded tax benefits of \$27 million in 2009 for the settlement of a tax dispute and foreign currency exchange losses.

See Note 5 to the Financial Statements for additional information on income taxes.

**Discontinued Operations**

See Note 9 to the Financial Statements for information related to:

- the anticipated sale of the Long Island generation business;
- the sale of the majority of the Maine hydroelectric generation business in 2009;
- the sale of the 8.33% interest in Wyman Unit 4 in 2009;
- the sale of the Latin American businesses in 2007 and the substantial dissolution of the remaining holding companies in 2008; and
- the sale of the natural gas distribution and propane businesses in 2008.

**Financial Condition**

**Liquidity and Capital Resources**

PPL expects to continue to have adequate liquidity available through operating cash flows, cash and cash equivalents and its credit facilities. Additionally, subject to market conditions, PPL currently plans to access debt capital markets in 2010. PPL currently does not plan to access commercial paper markets or equity capital markets in 2010.

PPL's cash flows from operations and access to cost-effective bank and capital markets are subject to risks and uncertainties including, but not limited to:

- changes in market prices for electricity;
- changes in commodity prices that may increase the cost of producing power or decrease the amount PPL receives from selling power;
- operational and credit risks associated with selling and marketing products in the wholesale power markets;
- potential ineffectiveness of the trading, marketing and risk management policy and programs used to mitigate PPL's risk exposure to adverse electricity and fuel prices, interest rates, foreign currency exchange rates and counterparty credit;
- unusual or extreme weather that may damage PPL's transmission and distribution facilities or affect energy sales to customers;
- reliance on transmission and distribution facilities that PPL does not own or control to deliver its electricity and natural gas;
- unavailability of generating units (due to unscheduled or longer-than-anticipated generation outages, weather and natural disasters) and the resulting loss of revenues and additional costs of replacement electricity;
- the ability to recover and the timeliness and adequacy of recovery of costs associated with regulated utility businesses;
- costs of compliance with existing and new environmental laws and with new security and safety requirements for nuclear facilities;
- any adverse outcome of legal proceedings and investigations with respect to PPL's current and past business activities;
- deterioration in the financial markets that could make obtaining new sources of bank and capital markets funding more difficult and more costly; and
- a downgrade in PPL's or its rated subsidiaries' credit ratings that could adversely affect their ability to access capital and increase the cost of credit facilities and any new debt.

See "Item 1A. Risk Factors" for further discussion of risks and uncertainties affecting PPL's cash flows.

At December 31, PPL had the following:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
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Cash and cash equivalents	\$	801	\$	1,100	\$	430
Short-term investments (a) (b)				150		108
	\$	801	\$	1,250	\$	538
Short-term debt	\$	639	\$	679	\$	92

(a) 2008 amount represents tax-exempt bonds issued by the PEDFA in December 2008 on behalf of PPL Energy Supply and purchased by a subsidiary of PPL Energy Supply upon issuance. Such bonds were refunded in April 2009. See Note 7 to the Financial Statements for further discussion.

(b) Includes \$15 million of auction rate securities at December 31, 2007. See below for a discussion of auction rate securities.

The changes in PPL's cash and cash equivalents position resulted from:

	2009	2008	2007
Net Cash Provided by Operating Activities	\$ 1,852	\$ 1,589	\$ 1,571
Net Cash Used in Investing Activities	(880)	(1,627)	(614)
Net Cash Provided by (Used in) Financing Activities	(1,271)	721	(1,326)
Effect of Exchange Rates on Cash and Cash Equivalents		(13)	5
Net Increase (Decrease) in Cash and Cash Equivalents	\$ (299)	\$ 670	\$ (364)

#### Auction Rate Securities

PPL held auction rate securities with an aggregate par value of \$25 million and \$29 million at December 31, 2009 and 2008. Historically, an active market existed for such investments, and the auctions provided an opportunity for investors either to hold an investment at a periodically reset interest rate or to sell the investment at its par value for immediate liquidity. In early 2008, investor concerns about credit and liquidity in the financial markets, generally, as well as investor concerns over specific insurers that guarantee the credit of certain of the underlying securities, created uncertainty in the auction rate securities market and these securities generally failed to be remarketed through their established auction process. The auctions continue to fail and the resulting illiquidity continues to impact PPL's investment in auction rate securities.

At December 31, 2008, PPL estimated that the fair value of its auction rate securities was \$24 million, which is reflected in "Other investments" on the Balance Sheet and represented a temporary decline of \$5 million from par value.

In 2009, PPL liquidated \$4 million of auction rate securities at par. At December 31, 2009, PPL estimated that the fair value of its auction rate securities was equal to par value, which was \$25 million and is reflected in "Other investments" on the Balance Sheet. PPL reversed the previously recorded temporary impairment.

Because PPL intends and has the ability to hold these auction rate securities until they can be liquidated at par value, PPL believes that it does not have significant exposure to realize losses on these securities. Based upon the evaluation of available information, PPL believes these investments continue to be of high credit quality. Additionally, PPL does not anticipate having to sell these securities to fund operations. See Notes 17 and 21 to the Financial Statements for further discussion of auction rate securities.

#### Operating Activities

Net cash provided by operating activities increased by 17%, or \$263 million in 2009 compared with 2008, primarily as a result of cash collateral received from counterparties and the benefit of lower income tax payments due to the change in method of accounting for certain expenditures for tax purposes. These increases were partially offset by a decrease in accounts payable and the unfavorable impact of foreign currency exchange rates in 2009 compared with 2008.

Net cash provided by operating activities increased by 1%, or \$18 million, in 2008 compared with 2007, primarily as a result of higher revenues, primarily due to the hedged sale of generation in the wholesale market, increased retail electric sales volumes and a 1.4% increase in domestic delivery sales prices, as well as less U.S. income tax payments, primarily as a result of a refund received in 2008, and operating losses incurred in 2007 in connection with synfuel projects that ceased operation at the end of 2007. The increases to cash provided by operating activities resulting from these items were partially offset by increased expenditures for fuel, primarily due to higher coal prices, lower realized net energy trading margins, driven by significant decreases in power and gas prices, higher interest paid, primarily due to higher debt levels in 2008, cash flows provided by Latin America's operations in 2007 but not 2008, due to the sale of the Latin American businesses in 2007, and an insurance recovery of storm costs in 2007.

A significant portion of PPL's operating cash flows is derived from its Supply segment baseload generation business activities. PPL employs a formal hedging program for its baseload generation fleet, the primary objective of which is to provide a reasonable level of near-term cash flow and earnings certainty over the next three years, while preserving upside potential if power prices increase over the medium term. See Note 18 to the Financial Statements for further discussion. Based on its generation portfolio contracting practices (including related fuel purchases and commitments), PPL expects to achieve relatively stable cash flows related to baseload generation during the next three years, although, future cash flows from operating activities are expected to be influenced more by commodity prices than during the past nine years when long-term supply contracts were in place between PPL EnergyPlus and PPL Electric. As discussed in "Item 1. Business," PPL estimates that, on average, approximately 94% of its total expected annual generation output (which includes baseload and other generation) for 2010 is committed under

power sales contracts. PPL has also entered into commitments of varying quantities and terms for the years 2011 and beyond. In addition, PPL expects to be able to achieve relatively stable cash flows related to PPL Electric's role as PLR due to contracts it has entered into to procure the 2010 and a portion of 2011 PLR electricity supply it expects to need for residential, small commercial and small industrial customers who do not choose an alternative supplier. See Note 14 to the Financial Statements for information on these energy purchase contracts.

PPL's contracts for the sale and purchase of electricity and fuel often require cash collateral or other credit enhancements, or reductions or terminations of a portion of the entire contract through cash settlement, in the event of a downgrade of PPL's or its subsidiaries' credit ratings or adverse changes in market prices. For example, in addition to limiting its trading ability, if PPL's or its subsidiaries' ratings were lowered to below "investment grade" and there was a 10% adverse movement in energy prices, PPL estimates that, based on its December 31, 2009 positions, it would have had to post additional collateral of approximately \$291 million, compared with \$815 million at December 31, 2008. PPL has in place risk management programs that are designed to monitor and manage its exposure to volatility of cash flows related to changes in energy and fuel prices, interest rates, foreign currency exchange rates, counterparty credit quality and the operating performance of its generating units.

#### Investing Activities

The primary use of cash in investing activities is capital expenditures. See "Forecasted Uses of Cash" for detail regarding capital expenditures in 2009 and projected expenditures for the years 2010 through 2012.

Net cash used in investing activities decreased 46%, or \$747 million in 2009 compared with 2008, primarily as a result of a change of \$289 million from restricted cash and cash equivalents, a change of \$249 million from purchases and sales of other investments, a change of \$241 million from purchases and sales of intangible assets and a decrease of \$193 million in capital expenditures. See Note 1 to the Financial Statements for a discussion of restricted cash and cash equivalents and Note 7 to the Financial Statements for a discussion of the purchase and sale by a subsidiary of PPL Energy Supply of Exempt Facilities Revenue Bonds issued by the PEDFA on behalf of PPL Energy Supply. The decrease in cash used in investing activities from the above items was partially offset by the change in proceeds received from the sale of businesses, which are discussed in Note 9 to the Financial Statements. PPL received \$303 million from the sale of the gas and propane businesses in 2008 compared to proceeds of \$81 million received from the sale of the majority of the Maine hydroelectric generation business in 2009.

Net cash used in investing activities increased 165%, or \$1.0 billion, in 2008 compared with 2007, as PPL received \$303 million from the sale of the gas and propane businesses in 2008 compared to aggregate proceeds of \$898 million received from the sale of the Latin American businesses and telecommunication operations in 2007. See Notes 8 and 9 to the Financial Statements for a discussion of these sales. Additionally, there was a change of \$354 million from purchases and sales of other investments and a change of \$359 million from purchases and sales of intangible assets. The increase in cash used in investing activities from the above items was partially offset by a decrease of \$239 million in capital expenditures and a decrease of \$54 million in the amount of cash and cash equivalents that became restricted.

#### Financing Activities

Net cash used in financing activities was \$1.3 billion in 2009 compared with \$721 million of cash provided by financing activities in 2008 and net cash used in financing activities of \$1.3 billion in 2007. The change from 2008 to 2009 primarily reflects fewer issuances and increased retirements of long-term debt in 2009, as well as the net repayment of short-term borrowings in 2009. The change from 2007 to 2008 primarily reflects increased issuances and lower retirements of long-term debt, lower repurchases of common stock and increased short-term borrowings in 2008.

In 2009, cash used in financing activities primarily consisted of net debt retirements of \$770 million and common stock dividends paid of \$517 million, partially offset by \$60 million of common stock sale proceeds.

In 2008, cash provided by financing activities primarily consisted of net debt issuances of \$1.3 billion and \$19 million of common stock sale proceeds, partially offset by common stock dividends paid of \$491 million and the repurchase of 802,816 shares of common stock for \$38 million.

In 2007, cash used in financing activities primarily consisted of net debt retirements of \$170 million, the repurchase of 14,929,892 shares of common stock for \$712 million and common stock dividends paid of \$459 million, partially offset by \$32 million of common stock sale proceeds. See Note 7 to the Financial Statements for a discussion of the common stock repurchase program.

See "Forecasted Sources of Cash" for a discussion of PPL's plans to issue debt and equity securities, as well as a discussion of credit facility capacity available to PPL. Also see "Forecasted Uses of Cash" for a discussion of plans to pay dividends on common and preferred securities in the future, as well as maturities of long-term debt.

PPL's debt financing activity in 2009 was:

	<u>Issuances (a)</u>	<u>Retirements</u>
PPL Capital Funding Senior Unsecured Notes		\$ (201)
PPL Energy Supply Senior Unsecured Notes (a)		(220)
PPL Electric Senior Secured Bonds (b)	\$ 298	(586)
Variable Rate Pollution Control Facilities Note		(9)



PPL Electric short-term debt		(95)
WPD short-term debt (net change)	43	
Total	\$ 341	\$ (1,111)
Net decrease		\$ (770)

- (a) In March 2009, PPL Energy Supply paid \$220 million, plus accrued interest, to complete tender offers to purchase up to \$250 million aggregate principal amount of certain of its outstanding senior notes in order to reduce future interest expense. Under the Economic Stimulus Package, PPL will be permitted to defer recognition of income related to the extinguishment of these notes for tax purposes. No amounts will be included in taxable income for the first five years. Beginning in 2014, income related to the extinguishment of these notes will be included in taxable income ratably over five years.
- (b) Issuance is net of pricing discount. Retirements exclude a \$9 million premium paid in connection with the December 2009 redemption of PPL Electric's 4.30% Senior Secured Bonds due 2013.

See Note 7 to the Financial Statements for more detailed information regarding PPL's financing activities in 2009.

#### Forecasted Sources of Cash

PPL expects to continue to have significant sources of cash available in the near term, including various credit facilities, a commercial paper program and operating leases. PPL currently does not plan to access commercial paper markets in 2010 and plans to issue up to \$300 million and £400 million in long-term debt securities in 2010, subject to market conditions.

#### Credit Facilities

At December 31, 2009, PPL's total committed borrowing capacity under credit facilities and the use of this borrowing capacity were:

	<u>Committed Capacity</u>	<u>Borrowed</u>	<u>Letters of Credit Issued (a)</u>	<u>Unused Capacity</u>
PPL Energy Supply Domestic Credit Facilities (b)	\$ 4,125	\$ 285	\$ 662	\$ 3,178
PPL Electric Credit Facilities (c)	340		6	334
Total Domestic Credit Facilities (d)	<u>\$ 4,465</u>	<u>\$ 285</u>	<u>\$ 668</u>	<u>\$ 3,512</u>
/PDH Limited Credit Facility (e)	£ 150	£ 132	n/a	£ 18
WPD (South West) Credit Facilities (f)	214	60	£ 3	151
Total WPD Credit Facilities (g)	<u>£ 364</u>	<u>£ 192</u>	<u>£ 3</u>	<u>£ 169</u>

- (a) The borrower under each of these facilities has a reimbursement obligation to the extent any letters of credit are drawn upon.
- (b) PPL Energy Supply has the ability to borrow \$3.6 billion under its credit facilities. Such borrowings generally bear interest at LIBOR-based rates plus a spread, depending upon the company's public debt rating. PPL Energy Supply also has the capability to cause the lenders to issue up to \$3.9 billion of letters of credit under these facilities, which issuances reduce available borrowing capacity. Under certain conditions, PPL Energy Supply may request that the capacity of one of its facilities be increased by up to \$500 million.

These credit facilities contain a financial covenant requiring debt to total capitalization to not exceed 65%. At December 31, 2009 and 2008, PPL Energy Supply's consolidated debt to total capitalization percentages, as calculated in accordance with its credit facilities, were 46% and 44%. The credit facilities also contain standard representations and warranties that must be made for PPL Energy Supply to borrow under them.

The committed capacity expires as follows: \$600 million in 2010, \$300 million in 2011 and \$3.2 billion in 2012. PPL Energy Supply intends to renew or replace the two credit facilities that expire in 2010 in order to maintain its current total committed capacity level.

- (c) Borrowings under PPL Electric's \$190 million syndicated credit facility generally bear interest at LIBOR-based rates plus a spread, depending upon the company's public debt rating. PPL Electric also has the capability to request the lenders to issue up to \$190 million of letters of credit under this facility, which issuances reduce available borrowing capacity. Under certain conditions, PPL Electric may request that the facility's capacity be increased by up to \$100 million.

The syndicated credit facility contains a financial covenant requiring debt to total capitalization to not exceed 70%. At December 31, 2009 and 2008, PPL Electric's consolidated debt to total capitalization percentages, as calculated in accordance with its credit facility, were 44% and 53%. The syndicated credit facility also contains standard representations and warranties that must be made for PPL Electric to borrow under it.

Committed capacity includes a \$150 million credit facility related to an asset-backed commercial paper program through which PPL Electric obtains financing by selling and contributing its eligible accounts receivable and unbilled revenues to a special purpose, wholly owned subsidiary on an ongoing basis. The subsidiary pledges these assets to secure loans of up to an aggregate of \$150 million from a commercial paper conduit sponsored by a financial institution. At December 31, 2009, based on accounts receivable and unbilled revenue

pledged, \$150 million was available for borrowing.

The committed capacity expires as follows: \$150 million in 2010 and \$190 million in 2012. PPL Electric intends to renew its existing \$150 million asset-backed credit facility in 2010 in order to maintain its current total committed capacity level.

- d) The commitments under PPL's domestic credit facilities are provided by a diverse bank group, with no one bank and its affiliates providing an aggregate commitment of more than 15% of the total committed capacity.
- (e) Borrowings under WPDH Limited's credit facility bear interest at LIBOR-based rates plus a spread, depending upon the company's public debt rating.

This credit facility contains financial covenants that require WPDH Limited to maintain an interest coverage ratio of not less than 3.0 times consolidated earnings before income taxes, depreciation and amortization and a RAB that exceeds total net debt by the higher of an amount equal to 15% of total net debt or £150 million, in each case as calculated in accordance with the credit facility. At December 31, 2009 and 2008, WPDH Limited's interest coverage ratios, as calculated in accordance with its credit facility, were 4.3 and 4.6. At December 31, 2009 and 2008, WPDH Limited's RAB, as calculated in accordance with the credit facility, exceeded its total net debt by £325 million, or 25%, and £385 million, or 31%.

- (f) WPD (South West) has two credit facilities: one under which it can make cash borrowings and another under which it has the capability to cause the lender to issue up to approximately £4 million of letters of credit. Borrowings bear interest at LIBOR-based rates plus a margin.

The credit facility under which it can make cash borrowings contains financial covenants that require WPD (South West) to maintain an interest coverage ratio of not less than 3.0 times consolidated earnings before income taxes, depreciation and amortization and total net debt not in excess of 85% of RAB, in each case as calculated in accordance with the credit facility. At December 31, 2009, WPD (South West)'s interest coverage ratio, as calculated in accordance with its credit facility, was 5.3. At December 31, 2009, WPD (South West)'s total net debt, as calculated in accordance with the credit facility, was 67% of RAB.

- (g) The commitments under WPD's credit facilities are provided by eight banks, with no one bank providing more than 25% of the total committed capacity.

The committed capacity of WPD's credit facilities expires as follows: £4 million in 2010, £210 million in 2012 and £150 million in 2013. WPD (South West) intends to renew its letter of credit facility that expires in 2010 in order for WPD to maintain its current total committed capacity level.

At December 31, 2009, the unused capacity of WPD's credit facilities was approximately \$276 million.

In addition to the financial covenants noted in the table above, the credit agreements governing the credit facilities contain various other covenants. Failure to comply with the covenants after applicable grace periods could result in acceleration of repayment of borrowings and/or termination of the agreements. PPL monitors compliance with the covenants on a regular basis. At December 31, 2009, PPL was in material compliance with these covenants. At this time, PPL believes that these covenants and other borrowing conditions will not limit access to these funding sources.

See Note 7 to the Financial Statements for further discussion of PPL's credit facilities.

#### *Commercial Paper*

PPL Energy Supply and PPL Electric usually maintain commercial paper programs, under which commercial paper issuances are supported by certain credit facilities of each company, to provide an additional financing source to fund their short-term liquidity needs, if and when necessary.

As discussed below under "Credit Ratings," S&P lowered its rating on PPL Energy Supply's commercial paper to A-3 from A-2 in January 2009. Since PPL Energy Supply did not plan to issue any commercial paper during 2009 and there was essentially no liquidity in commercial paper markets for paper with an A-3 rating, PPL Energy Supply closed its \$500 million commercial paper program in January 2009 and requested that Moody's, S&P and Fitch each withdraw their ratings on its commercial paper program, which each rating agency subsequently did.

PPL Energy Supply may reopen its commercial paper program in the future, depending on market conditions and credit ratings, to provide an additional financing source to fund its short-term liquidity needs, if and when necessary. Any future commercial paper issuances would be supported by PPL Energy Supply's credit facilities.

PPL Electric has a \$200 million commercial paper program in place. As noted below under "Credit Ratings," commercial paper for PPL Electric is rated P-2, A-2 and F2 by Moody's, S&P and Fitch. Market conditions to issue commercial paper with these ratings have strengthened significantly since 2008, when the downturn in the financial markets created extremely limited liquidity resulting in high borrowing rates. PPL Electric did not issue any commercial paper during 2009. Based on its current cash position and anticipated cash flows, PPL Electric currently does not plan to issue any commercial paper during 2010, but it may do so from time to time, subject to market conditions, to facilitate short-term cash flow needs.

#### *Operating Leases*

PPL and its subsidiaries also have available funding sources that are provided through operating leases. PPL's subsidiaries lease office space, land, buildings and certain equipment. These leasing structures provide PPL additional operating and financing flexibility. The operating leases contain covenants that are typical for these agreements, such as maintaining insurance, maintaining corporate existence and timely payment of rent and other fees.

PPL, through its subsidiary PPL Montana, leases a 50% interest in Colstrip Units 1 and 2 and a 30% interest in Unit 3, under four 36-year, non-cancelable operating leases. These operating leases are not recorded on PPL's Balance Sheets. The leases place certain restrictions on PPL Montana's ability to incur additional debt, sell assets and declare dividends. At this time, PPL believes that these restrictions will not limit access to these funding sources or cause acceleration or termination of the leases. See Note 7 to the Financial Statements for a discussion of other dividend restrictions related to PPL subsidiaries.

See Note 10 to the Financial Statements for further discussion of the operating leases.

#### *Long-Term Debt and Equity Securities*

Subject to market conditions, PPL and its subsidiaries currently plan to issue up to \$300 million and £400 million in long-term debt securities in 2010. PPL expects to use the proceeds from these issuances for the repayment of short-term debt, to fund capital expenditures, and for general corporate purposes.

PPL currently plans to issue new shares of common stock in 2010 in an aggregate amount of approximately \$75 million under various employee stock-based compensation plans and its dividend reinvestment plan.

#### Forecasted Uses of Cash

In addition to expenditures required for normal operating activities, such as purchased power, payroll, fuel and taxes, PPL currently expects to incur future cash outflows for capital expenditures, various contractual obligations, payment of dividends on its common and preferred securities and possibly the purchase or redemption of a portion of debt securities.

#### *Capital Expenditures*

The table below shows PPL's actual spending for the year 2009 and current capital expenditure projections for the years 2010 through 2012.

	Actual	Projected		
	2009	2010	2011	2012
Construction expenditures (a) (b)				
Generating facilities	\$ 361	\$ 671	\$ 673	\$ 507
Transmission and distribution facilities	511	862	1,097	990
Environmental	178	63	19	99
Other	75	114	107	106
Total Construction Expenditures	1,125	1,710	1,896	1,702
Nuclear fuel	140	151	173	171
Total Capital Expenditures	\$ 1,265	\$ 1,861	\$ 2,069	\$ 1,873

(a) Construction expenditures include capitalized interest and AFUDC, which are expected to be approximately \$190 million for the years 2010 through 2012.

(b) Includes expenditures for certain intangible assets.

PPL's capital expenditure projections for the years 2010 through 2012 total approximately \$5.8 billion. Capital expenditure plans are revised periodically to reflect changes in operational, market and regulatory conditions. This table includes projected costs related to the planned 239 MW of incremental capacity increases, PPL Electric's asset optimization program focused on the replacement of aging transmission and distribution assets, and the PJM-approved regional transmission line expansion project. See Note 8 to the Financial Statements for information on the PJM-approved regional transmission line expansion project and the other significant development projects.

PPL plans to fund its capital expenditures in 2010 with cash on hand, cash from operations and proceeds from the issuance of debt securities.

#### *Contractual Obligations*

PPL has assumed various financial obligations and commitments in the ordinary course of conducting its business. At December 31, 2009, the estimated contractual cash obligations of PPL were:

	Total	Less Than 1 Year	1-3 Years	4-5 Years	After 5 Years
Long-term Debt (a)	\$ 7,066		\$ 500	\$ 1,447	\$ 5,119
Interest on Long-term Debt (b)	8,342	\$ 421	812	705	6,404
Operating Leases	968	108	216	223	421

Purchase Obligations (c)	8,123	3,153	2,212	868	1,890
Other Long-term Liabilities Reflected on the Balance Sheet under GAAP (d) (e)	80	62	18		
Total Contractual Cash Obligations	<u>\$ 24,579</u>	<u>\$ 3,744</u>	<u>\$ 3,758</u>	<u>\$ 3,243</u>	<u>\$ 13,834</u>

- a) Reflects principal maturities only based on legal maturity dates. See Note 7 to the Financial Statements for a discussion of the remarketing feature related to PPL Energy Supply's 5.70% REset Put Securities, as well as discussion of variable-rate remarketable bonds issued by the PEDFA on behalf of PPL Energy Supply and PPL Electric. PPL does not have any significant capital lease obligations.
- b) Assumes interest payments through maturity. The payments herein are subject to change, as payments for debt that is or becomes variable-rate debt have been estimated and payments denominated in British pounds sterling have been translated to U.S. dollars at a current foreign currency exchange rate.
- c) The payments reflected herein are subject to change, as certain purchase obligations included are estimates based on projected obligated quantities and/or projected pricing under the contracts. Purchase orders made in the ordinary course of business are excluded from the amounts presented. The payments also include obligations related to nuclear fuel and the installation of the scrubbers, which are also reflected in the Capital Expenditures table presented above.
- d) The amounts reflected represent WPD's contractual deficit pension funding requirements arising from an actuarial valuation performed in March 2007. The U.K. electricity regulator currently allows a recovery of a substantial portion of the contributions relating to the plan deficit; however, WPD cannot be certain that this will continue beyond the current and next review periods, which extend to March 31, 2015. Based on the current funded status of PPL's U.S. qualified pension plans, no cash contributions are required. See Note 12 to the Financial Statements for a discussion of expected contributions.
- e) At December 31, 2009, total unrecognized tax benefits of \$212 million were excluded from this table as PPL cannot reasonably estimate the amount and period of future payments. See Note 5 to the Financial Statements for additional information.

#### Dividends

PPL views dividends as an integral component of shareowner return and expects to continue to pay dividends in amounts that are within the context of maintaining a capitalization structure that supports investment grade credit ratings. In 2009, PPL increased the annualized dividend rate on its common stock from \$1.34 to \$1.38 per share, effective with the April 1, 2009 dividend payment. Future dividends will be declared at the discretion of the Board of Directors and will depend upon available earnings, cash flows, financial requirements and other relevant factors at the time. As discussed in Note 7 to the Financial Statements, PPL may not declare or pay any cash dividend on its common stock during any period in which PPL Capital Funding defers interest payments on its 2007 Series A Junior Subordinated Notes due 2067. No such deferrals have occurred or are currently anticipated.

<sup>^</sup>PPL Electric expects to continue to pay quarterly dividends on its outstanding preferred securities, if and as declared by its Board of Directors.

See Note 7 to the Financial Statements for other restrictions related to distributions on capital interests for PPL subsidiaries.

#### Purchase or Redemption of Debt Securities

PPL will continue to evaluate purchasing or redeeming outstanding debt securities and may decide to take action depending upon prevailing market conditions and available cash.

#### Credit Ratings

Moody's, S&P and Fitch periodically review the credit ratings on the debt and preferred securities of PPL and its subsidiaries. Based on their respective independent reviews, the rating agencies may make certain ratings revisions or ratings affirmations.

A credit rating reflects an assessment by the rating agency of the creditworthiness associated with an issuer and particular securities that it issues. The credit ratings of PPL and its subsidiaries are based on information provided by PPL and other sources. The ratings of Moody's, S&P and Fitch are not a recommendation to buy, sell or hold any securities of PPL or its subsidiaries. Such ratings may be subject to revisions or withdrawal by the agencies at any time and should be evaluated independently of each other and any other rating that may be assigned to the securities. A downgrade in PPL's or its subsidiaries' credit ratings could result in higher borrowing costs and reduced access to capital markets.

The following table summarizes the credit ratings of PPL and its rated subsidiaries at December 31, 2009:

	<u>Moody's</u>	<u>S&amp;P</u>	<u>Fitch (a)</u>
<b>PPL</b>			
Issuer Rating	Baa2	BBB	BBB
Outlook	Negative	Negative	STABLE
<b>PPL Capital Funding</b>			
Issuer Rating			BBB
Senior Unsecured Debt	Baa2	BBB-	BBB
Junior Subordinated Notes	Baa3	BB+	BBB-
Outlook	Negative		STABLE

#### PPL Energy Supply (b)

Issuer Rating		BBB	BBB
Senior Unsecured Notes	Baa2	BBB	BBB
Outlook	STABLE	Negative	STABLE
<b>PPL Electric (c)</b>			
Senior Unsecured/Issuer Rating	Baa1	A-	BBB
First Mortgage Bonds/ Senior Secured Bonds	A3	A-	A-
Commercial Paper	P-2	A-2	F2
Preferred Stock	Baa3	BBB	BBB
Preference Stock	Baa3	BBB	BBB
Outlook	Negative	Negative	STABLE
<b>PPL Montana</b>			
Pass-Through Certificates	Baa3	BBB-	BBB
Outlook	STABLE	STABLE	
<b>WPDH Limited</b>			
Issuer Rating	Baa3	BBB-	BBB-
Senior Unsecured Debt	Baa3	BBB-	BBB
Short-term Debt		A-3	
Outlook	STABLE	Negative	POSITIVE
<b>WPD LLP</b>			
Issuer Rating			BBB
Outlook			POSITIVE
<b>WPD (South Wales)</b>			
Issuer Rating		BBB+	BBB+
Senior Unsecured Debt	Baa1	BBB+	A-
Short-term Debt		A-2	F2
Outlook	STABLE	Negative	POSITIVE
<b>WPD (South West)</b>			
Issuer Rating	Baa1	BBB+	BBB+
Senior Unsecured Debt	Baa1	BBB+	A-
Short-term Debt	P-2	A-2	F2
Outlook	STABLE	Negative	POSITIVE

(a) All Issuer Ratings for Fitch are "Issuer Default Ratings."

(b) Excludes Exempt Facilities Revenue Bonds issued by the PEDFA on behalf of PPL Energy Supply, which are each currently supported by a letter of credit and are rated on the basis of the credit enhancement.

(c) Excludes Pollution Control Revenue Bonds issued by the LCIDA and the PEDFA on behalf of PPL Electric, of which the LCIDA bonds are insured and may be rated on the basis of relevant factors, including the insurer's ratings.

In January 2009, S&P completed a review of PPL, PPL Energy Supply and PPL Electric and revised its outlook for all three entities to negative from stable. At that time, S&P affirmed the BBB issuer rating of both PPL and PPL Energy Supply and affirmed the A- issuer rating of PPL Electric. As a result of the negative outlook at PPL Energy Supply, S&P lowered the commercial paper rating of PPL Energy Supply to A-3 from A-2. S&P stated in its press release regarding PPL and PPL Energy Supply that the revision in the outlook for PPL and PPL Energy Supply was based primarily on lower than expected cash flows for 2008 combined with concerns over further pressure on financial metrics in 2009. S&P stated in its press release regarding PPL Electric that the revision in its outlook reflects the linkage with PPL along with their expectation that PPL Electric's financial metrics could weaken beginning in 2010.

At the request of PPL Energy Supply, in the first quarter of 2009, Moody's, S&P and Fitch each withdrew their commercial paper rating for PPL Energy Supply.

In February 2009, S&P revised its outlook to negative from stable for each of WPDH Limited, WPD LLP, WPD (South Wales) and WPD (South West) and affirmed the issuer and short-term debt ratings of each of the entities. S&P stated in its press release that the revision in the outlook is a reflection of the change to PPL's outlook and is not a result of any change in WPD's stand-alone credit profile.

In May 2009, Moody's completed a review of PPL, PPL Energy Supply and PPL Electric. As a result of that review, Moody's revised its outlook for PPL, PPL Capital Funding, and PPL Electric to negative from stable. At the same time, Moody's affirmed the Baa2 senior unsecured rating and stable outlook of PPL Energy Supply. Moody's stated in its press release that the revision in the outlook for PPL Electric reflects Moody's expectation that PPL Electric's financial metrics will deteriorate beyond 2009 and considers the potential for additional pressure on cash flows. Moody's also stated that the revision in the outlook for PPL and PPL Capital Funding reflects the increasing support for corporate earnings and cash flow anticipated from PPL Energy Supply and the subordinate position of the unsecured lenders at these entities relative to the unsecured lenders at the subsidiary levels.

At WPD's request, in September 2009, S&P withdrew its ratings for WPD LLP, since it did not have any securities outstanding.

In October 2009, Fitch completed a review of PPL, PPL Electric and PPL Energy Supply. As a result of that review, Fitch lowered the rating of PPL Energy Supply's senior unsecured notes to BBB from BBB+ and affirmed all other ratings of PPL Energy Supply. At the same time, Fitch affirmed all ratings of PPL, PPL Capital Funding and PPL Electric. Fitch stated in its press release that the change in the rating of PPL Energy Supply's senior unsecured notes aligns such rating with the BBB Issuer Default Rating in a manner that is consistent with the approach Fitch applies to other competitive generators and also recognizes a lower valuation of PPL Energy Supply's power assets based on current and forward wholesale power prices. The rating also reflects Fitch's forecast of lower than previously expected improvement in PPL Energy Supply's earnings and cash flow in 2010 and 2011.

In January 2010, as a result of implementing its recently revised guidelines for rating preferred stock and hybrid securities, Fitch lowered the rating of PPL Capital Funding's junior subordinated notes to BB+ from BBB- and lowered the ratings of PPL Electric's preferred stock and preference stock to BBB- from BBB. Fitch stated in its press release that the new guidelines, which apply to instruments issued by companies in all sectors, typically resulted in downgrades of one notch for many instruments that provide for the ability to defer interest or dividend payments. Fitch stated that it has no reason to believe that deferral will be activated.

#### Ratings Triggers

WPD (South West)'s 1.541% Index-linked Notes due 2053 and 2056 and WPD (South Wales)'s 4.80436% Notes due 2037 may be put by the holders back to the issuer for redemption if the long-term credit ratings assigned to the notes by Moody's, S&P or Fitch are withdrawn by any of the rating agencies or reduced to a non-investment grade rating of Ba1 or BB+ in connection with a restructuring event. A restructuring event includes the loss of, or a material adverse change to, the distribution license under which WPD (South West) and WPD (South Wales) operate. These notes totaled £467 million (approximately \$766 million) at December 31, 2009.

PPL and PPL Energy Supply have various derivative and non-derivative contracts, including contracts for the sale and purchase of electricity and fuel, commodity transportation and storage, tolling agreements, and interest rate and foreign currency instruments, which contain provisions requiring PPL and PPL Energy Supply to post additional collateral, or permit the counterparty to terminate the contract, if PPL's or PPL Energy Supply's credit rating were to fall below investment grade. See Note 18 to the Financial Statements for a discussion of "Credit Risk-Related Contingent Features," including a discussion of the potential additional collateral that would have been required for derivative contracts in a net liability position at December 31, 2009. At December 31, 2009, if PPL's and PPL Energy Supply's credit ratings had been below investment grade, PPL would have been required to post an additional \$298 million of collateral to counterparties for both derivative and non-derivative commodity and commodity-related contracts used in its generation, marketing and trading operations and interest rate and foreign currency contracts.

#### Guarantees for Subsidiaries

At times, PPL provides guarantees for financing arrangements to enable certain transactions for its consolidated affiliates, excluding PPL Electric. Some of the guarantees contain financial and other covenants that, if not met, would limit or restrict the consolidated affiliates' access to funds under these financing arrangements, require early maturity of such arrangements or limit the consolidated affiliates' ability to enter into certain transactions. At this time, PPL believes that these covenants will not limit access to relevant funding sources. See Note 14 to the Financial Statements for additional information about guarantees.

#### **Off-Balance Sheet Arrangements**

PPL has entered into certain agreements that may contingently require payment to a guaranteed or indemnified party. See Note 14 to the Financial Statements for a discussion of these agreements.

#### **Risk Management - Energy Marketing & Trading and Other**

##### Market Risk

See Notes 1, 17, and 18 to the Financial Statements for information about PPL's risk management objectives, valuation techniques and accounting designations.

The forward-looking information presented below provides estimates of what may occur in the future, assuming certain adverse market conditions and model assumptions. Actual future results may differ materially from those presented. These disclosures are not precise indicators of expected future losses, but only indicators of possible losses under normal market conditions at a given confidence level.

##### *Commodity Price Risk (Non-trading)*

PPL segregates its non-trading activities into two categories: hedge activity and economic activity. Transactions that are accounted for as hedge activity qualify for hedge accounting treatment. The economic activity category includes transactions that address a specific risk, but were not eligible for hedge accounting or for which hedge accounting was not elected. This activity includes the changes in fair value of positions used to hedge a portion of the economic value of PPL's generation assets, load-following and retail activities. This economic activity is subject to changes in fair value due to market price volatility of the input and output commodities (e.g., fuel and power). Although they do not receive hedge accounting treatment, these transactions are considered non-trading activity. The net fair value of economic positions at December 31, 2009 and 2008 was a net liability of \$77 million and \$52 million. See Note 18 for additional information on economic activity.

To hedge the impact of market price volatility on PPL's energy-related assets, liabilities and other contractual arrangements, PPL EnergyPlus

sells and purchases physical energy at the wholesale level under FERC market-based tariffs throughout the U.S. and enters into financial exchange-traded and over-the-counter contracts. PPL's non-trading commodity derivative contracts mature at various times through 2017.

Within PPL's non-trading portfolio, the decision to enter into energy contracts is influenced by the expected value of PPL's generation. In determining the number of MWhs that are available to be sold forward, PPL first reduces the potential output by the amount of unavailable generation due to planned maintenance on a particular unit. The potential output is further reduced by the amount of MWhs that historically is not produced by a plant due to such factors as equipment breakage. Finally, the potential output of certain plants (such as peaking units) is reduced if their higher cost of production will not allow them to economically run during all hours.

PPL's non-trading portfolio also includes full requirements energy contracts. The net obligation to serve these contracts changes minute-by-minute. Anticipated usage patterns and energy peaks are affected by expected load changes, regional economic drivers, customer shopping or migration and seasonal weather patterns. PPL analyzes historical on-peak and off-peak usage patterns, expected load changes, regional economic drivers, and weather patterns, among other factors, to determine monthly levels of electricity that best fits usage patterns to minimize earnings exposure. To satisfy its full requirements obligations, PPL generally enters into contracts to purchase unbundled products of electricity, capacity, RECs and other ancillary products. To a lesser extent, PPL reserves a portion of its generation for full requirements contracts that is expected to be the best match with anticipated usage patterns and energy peaks.

The following chart sets forth the net fair value of PPL's non-trading commodity derivative contracts. See Notes 17 and 18 to the Financial Statements for additional information.

	Gains (Losses)	
	2009	2008
Fair value of contracts outstanding at the beginning of the period	\$ 402	\$ (305)
Contracts realized or otherwise settled during the period	189	(49)
Fair value of new contracts entered into during the period	143	101
Changes in fair value attributable to changes in valuation techniques (a)		158
Other changes in fair value	546	497
Fair value of contracts outstanding at the end of the period	<u>\$ 1,280</u>	<u>\$ 402</u>

(a) Amount represents the reduction of valuation reserves related to capacity and FTR contracts upon the adoption of fair value accounting guidance.

The following table segregates the net fair value of PPL's non-trading commodity derivative contracts at December 31, 2009 based on whether the fair value was determined by prices quoted in active markets for identical instruments or other more subjective means.

Source of Fair Value	Net Asset (Liability)				Total Fair Value
	Maturity Less Than 1 Year	Maturity 1-3 Years	Maturity 4-5 Years	Maturity In Excess of 5 Years	
Prices quoted in active markets for identical instruments					
Prices based on significant other observable inputs	\$ 363	\$ 736	\$ 73		\$ 1,172
Prices based on significant unobservable inputs	(1)	13	30	\$ 66	108
Fair value of contracts outstanding at the end of the period	<u>\$ 362</u>	<u>\$ 749</u>	<u>\$ 103</u>	<u>\$ 66</u>	<u>\$ 1,280</u>

PPL sells electricity, capacity and related services and buys fuel on a forward basis to hedge the value of energy from its generation assets. If PPL were unable to deliver firm capacity and energy or to accept the delivery of fuel under its agreements, under certain circumstances it could be required to pay liquidating damages. These damages would be based on the difference between the market price and the contract price of the commodity. Depending on price changes in the wholesale energy markets, such damages could be significant. Extreme weather conditions, unplanned power plant outages, transmission disruptions, nonperformance by counterparties (or their own counterparties) with which it has energy contracts and other factors could affect PPL's ability to meet its obligations, or cause significant increases in the market price of replacement energy. Although PPL attempts to mitigate these risks, there can be no assurance that it will be able to fully meet its firm obligations, that it will not be required to pay damages for failure to perform, or that it will not experience counterparty nonperformance in the future.

#### Commodity Price Risk (Trading)

PPL's trading contracts mature at various times through 2015. The following table sets forth changes in the net fair value of PPL's trading commodity derivative contracts. See Notes 17 and 18 to the Financial Statements for additional information.

	Gains (Losses)	
	2009	2008

Fair value of contracts outstanding at the beginning of the period	\$	(75)	\$	16
Contracts realized or otherwise settled during the period		2		(18)
Fair value of new contracts entered into during the period		31		28
Changes in fair value attributable to changes in valuation techniques (a)				11
Other changes in fair value		36		(112)
Fair value of contracts outstanding at the end of the period	\$	<u>(6)</u>	\$	<u>(75)</u>

(a) In the fourth quarter of 2008, PPL refined its valuation approach for FTR and PJM basis positions, consistent with PPL's practice of pricing other less active trading points, resulting in changes in valuation techniques.

PPL will reverse unrealized gains of approximately \$1 million over the next three months as the transactions are realized.

The following table segregates the net fair value of PPL's trading commodity derivative contracts at December 31, 2009 based on whether the fair value was determined by prices quoted in active markets for identical instruments or other more subjective means.

Source of Fair Value	Net Asset (Liability)				Total Fair Value
	Maturity Less Than 1 Year	Maturity 1-3 Years	Maturity 4-5 Years	Maturity in Excess of 5 Years	
Prices quoted in active markets for identical instruments	\$ 1				\$ 1
Prices based on significant other observable inputs	(4)	\$ (5)	\$ 2	\$ 1	(6)
Prices based on significant unobservable inputs	(1)				(1)
Fair value of contracts outstanding at the end of the period	<u>\$ (4)</u>	<u>\$ (5)</u>	<u>\$ 2</u>	<u>\$ 1</u>	<u>\$ (6)</u>

#### VaR Models

PPL utilizes a VaR model to measure commodity price risk in domestic gross energy margins for its non-trading and trading portfolios. VaR is a statistical model that attempts to estimate the value of potential loss over a given holding period under normal market conditions at a given confidence level. PPL calculates VaR using a Monte Carlo simulation technique based on a five-day holding period at a 95% confidence level. Given the company's conservative hedging program, PPL's non-trading VaR exposure is expected to be limited in the short term. At December 31, 2009 and December 31, 2008, the VaR for PPL's portfolios using end-of-quarter results for the period was as follows.

95% Confidence Level, Five-Day Holding Period	Trading VaR		Non-Trading VaR	
	2009	2008	2009	2008
Period End	\$ 3	\$ 3	\$ 8	\$ 10
Average for the Period	4	10	9	14
High	8	22	11	20
Low	1	3	8	9

The trading portfolio includes all speculative positions, regardless of the delivery period. All positions not considered speculative are considered non-trading. PPL's non-trading portfolio includes PPL's entire portfolio, including generation, with delivery periods through the next 12 months. Both the trading and non-trading VaR computations exclude FTRs due to the absence of reliable spot and forward markets. The fair value of the FTR positions at December 31, 2009 was an unrealized loss of \$3 million and consisted of the following.

	2010	2011
Trading (a)		
Non-trading	\$ (2)	\$ (1)
Total	<u>\$ (2)</u>	<u>\$ (1)</u>

(a) The amount of trading FTR positions was less than \$1 million at December 31, 2009.

#### Interest Rate Risk

PPL and its subsidiaries have issued debt to finance their operations, which exposes them to interest rate risk. PPL utilizes various financial derivative instruments to adjust the mix of fixed and floating interest rates in its debt portfolio, adjust the duration of its debt portfolio and lock in benchmark interest rates in anticipation of future financing, when appropriate. Risk limits under the risk management program are designed to balance risk exposure to volatility in interest expense and changes in the fair value of PPL's debt portfolio due to changes in the absolute level of interest rates.



At December 31, 2009, PPL's potential annual exposure to increased interest expense, based on a 10% increase in interest rates, was \$1 million, compared with \$3 million at December 31, 2008.

PPL is also exposed to changes in the fair value of its domestic and international debt portfolios. PPL estimated that a 10% decrease in interest rates at December 31, 2009 would increase the fair value of its debt portfolio by \$285 million, compared with \$327 million at December 31, 2008.

At December 31, PPL had the following interest rate hedges outstanding.

	2009			2008		
	Exposure Hedged	Fair Value, Net - Asset (Liability) (a)	Effect of a 10% Adverse Movement in Rates (b)	Exposure Hedged	Fair Value, Net - Asset (Liability) (a)	Effect of a 10% Adverse Movement in Rates (b)
Cash flow hedges						
Interest rate swaps (c)	\$ 425	\$ 24	\$ (24)	\$ 200	\$ (11)	\$ (12)
Cross-currency swaps (d)	302	8	(41)	302	54	(8)
Fair value hedges						
Interest rate swaps (e)	750	31	(12)	500	54	(5)

(a) Includes accrued interest, if applicable.

(b) Effects of adverse movements decrease assets or increase liabilities, as applicable, which could result in an asset becoming a liability.

(c) PPL utilizes various risk management instruments to reduce its exposure to the expected future cash flow variability of its debt instruments. These risks include exposure to adverse interest rate movements for outstanding variable rate debt and for future anticipated financing. While PPL is exposed to changes in the fair value of these instruments, any changes in the fair value of these instruments are recorded in equity and then reclassified into earnings in the same period during which the item being hedged affects earnings. Sensitivities represent a 10% adverse movement in interest rates.

(d) WPDH Limited uses cross-currency swaps to hedge the interest payments and principal of its U.S. dollar-denominated senior notes with maturity dates ranging from December 2017 to December 2028. While PPL is exposed to changes in the fair value of these instruments, any change in the fair value of these instruments is recorded in equity and reclassified into earnings in the same period during which the item being hedged affects earnings. Sensitivities represent a 10% adverse movement in both interest rates and foreign currency exchange rates.

(e) PPL utilizes various risk management instruments to adjust the mix of fixed and floating interest rates in its debt portfolio. The change in fair value of these instruments, as well as the offsetting change in the value of the hedged exposure of the debt, is reflected in earnings. Sensitivities represent a 10% adverse movement in interest rates.

#### Foreign Currency Risk

PPL is exposed to foreign currency risk, primarily through investments in U.K. affiliates. In addition, PPL's domestic operations may make purchases of equipment in currencies other than U.S. dollars. See Note 1 to the Financial Statements for additional information regarding foreign currency translation.

PPL has adopted a foreign currency risk management program designed to hedge certain foreign currency exposures, including firm commitments, recognized assets or liabilities, anticipated transactions and net investments. In addition, PPL enters into financial instruments to protect against foreign currency translation risk of expected earnings.

At December 31, PPL had the following foreign currency hedges outstanding.

	2009			2008		
	Exposure Hedged	Fair Value, Net - Asset (Liability)	Effect of a 10% Adverse Movement in Foreign Currency Exchange Rates (a)	Exposure Hedged	Fair Value, Net - Asset (Liability)	Effect of a 10% Adverse Movement in Foreign Currency Exchange Rates (a)
Net investment hedges (b)	£ 40	\$ 13	\$ (6)	£ 68	\$ 34	\$ (10)
Economic hedges (c)	48	2	(4)			

(a) Effects of adverse movements decrease assets or increase liabilities, as applicable, which could result in an asset becoming a liability.

(b) To protect the value of a portion of its net investment in WPD, PPL executed forward contracts to sell British pounds sterling. The

settlement dates of these contracts range from March 2010 through June 2011.

- (c) To economically hedge the translation of 2010 expected income denominated in British pounds sterling to U.S. dollars, PPL entered into a combination of average rate forwards and average rate options to sell British pounds sterling. The forwards and options have termination dates ranging from January 2010 through June 2010.

#### *IDT Funds - Securities Price Risk*

In connection with certain NRC requirements, PPL Susquehanna maintains trust funds to fund certain costs of decommissioning the Susquehanna nuclear station. At December 31, 2009, these funds were invested primarily in domestic equity securities and fixed-rate, fixed-income securities and are reflected at fair value on PPL's Balance Sheet. The mix of securities is designed to provide returns sufficient to fund Susquehanna's decommissioning and to compensate for inflationary increases in decommissioning costs. However, the equity securities included in the trusts are exposed to price fluctuation in equity markets, and the values of fixed-rate, fixed-income securities are exposed to changes in interest rates. PPL actively monitors the investment performance and periodically reviews asset allocation in accordance with its nuclear decommissioning trust policy statement. At December 31, 2009, a hypothetical 10% increase in interest rates and a 10% decrease in equity prices would have resulted in an estimated \$40 million reduction in the fair value of the trust assets, compared with \$27 million at December 31, 2008. See Notes 17 and 21 to the Financial Statements for additional information regarding the NDT funds.

#### *Defined Benefit Plans - Securities Price Risk*

See "Application of Critical Accounting Policies - Defined Benefits" for additional information regarding the effect of securities price risk on plan assets.

#### Credit Risk

Credit risk is the risk that PPL would incur a loss as a result of nonperformance by counterparties of their contractual obligations. PPL maintains credit policies and procedures with respect to counterparty credit (including requirements that counterparties maintain specified credit ratings) and requires other assurances in the form of credit support or collateral in certain circumstances in order to limit counterparty credit risk. However, PPL has concentrations of suppliers and customers among electric utilities, financial institutions and other energy marketing and trading companies. These concentrations may impact PPL's overall exposure to credit risk, positively or negatively, as counterparties may be similarly affected by changes in economic, regulatory or other conditions.

PPL includes the effect of credit risk on its fair value measurements to reflect the probability that a counterparty will default when contracts are out of the money (from the counterparty's standpoint). In this case, PPL would have to sell into a lower-priced market or purchase from a higher-priced market. When necessary, PPL records an allowance for doubtful accounts to reflect the probability that a counterparty will not pay for deliveries PPL has made but not yet billed, which are reflected in "Unbilled revenues" on the Balance Sheets. PPL also has established a reserve with respect to certain sales to the California ISO for which PPL has not yet been paid, which is reflected in accounts receivable on the Balance Sheets. See Note 14 to the Financial Statements for additional information.

In 2007, the PUC approved PPL Electric's post-rate cap plan to procure default electricity supply for retail customers who do not choose an alternative competitive supplier in 2010. From 2007 through 2009, PPL Electric conducted six competitive solicitations to purchase electricity generation supply for these customers.

In October 2009, PPL Electric purchased 2010 supply for fixed-price default service to large commercial and large industrial customers who elect to take that service. In November 2009, PPL Electric purchased supply to provide hourly default service to large commercial and industrial customers in 2010.

In June 2009, the PUC approved PPL Electric's procurement plan for the period January 2011 through May 2013. The first two of 14 planned competitive solicitations occurred in 2009.

Under the standard Supply Master Agreement (the Agreement) for the bid solicitation process, PPL Electric requires all suppliers to post collateral if their credit exposure exceeds an established credit limit. In the event a supplier defaults on its obligation, PPL Electric would be required to seek replacement power in the market. All incremental costs incurred by PPL Electric would be recoverable from customers in future rates. At December 31, 2009, all of the successful bidders under all of the solicitations had an investment grade credit rating from S&P, and were not required to post collateral under the Agreement. There is no instance under the Agreement in which PPL Electric is required to post collateral to its suppliers.

See "Overview" in this Item 7 and Notes 14, 15, 17 and 18 to the Financial Statements for additional information on the competitive solicitations, the Agreement, credit concentration and credit risk.

#### **Related Party Transactions**

PPL is not aware of any material ownership interests or operating responsibility by senior management of PPL, PPL Energy Supply or PPL Electric in outside partnerships, including leasing transactions with variable interest entities, or other entities doing business with PPL.

For additional information on related party transactions, see Note 15 to the Financial Statements.

#### **Acquisitions, Development and Divestitures**

PPL is currently planning incremental capacity increases of 239 MW, primarily at its existing generating facilities. See "Item 2. Properties - Supply Segment" for additional information.

PPL continuously reexamines development projects based on market conditions and other factors to determine whether to proceed with the projects, sell, cancel or expand them, execute tolling agreements or pursue other options.

See Notes 8 and 9 to the Financial Statements for additional information on the more significant activities.

### **Environmental Matters**

See "Item 1. Business - Environmental Matters" and Note 14 to the Financial Statements for a discussion of environmental matters.

### **Competition**

See "Item 1. Business - Competition" under each of PPL's reportable segments and "Item 1A. Risk Factors" for a discussion of competitive factors affecting PPL.

### **New Accounting Guidance**

See Notes 1 and 22 to the Financial Statements for a discussion of new accounting guidance adopted and pending adoption.

### **Application of Critical Accounting Policies**

PPL's financial condition and results of operations are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. The following accounting policies are particularly important to the financial condition or results of operations of PPL, and require estimates or other judgments of matters inherently uncertain. Changes in the estimates or other judgments included within these accounting policies could result in a significant change to the information presented in the Financial Statements (these accounting policies are also discussed in Note 1 to the Financial Statements). PPL's senior management has reviewed these critical accounting policies and the estimates and assumptions regarding them with its Audit Committee. In addition, PPL's senior management has reviewed the following disclosures regarding the application of these critical accounting policies with the Audit Committee.

Effective January 1, 2009, PPL and its subsidiaries fully applied accounting guidance that provides a framework for measuring fair value. The fair value measurement concepts provided by this guidance are used within its financial statements where applicable. See Notes 1 and 17 to the Financial Statements for additional information regarding fair value measurements.

#### **1) Price Risk Management**

See "Risk Management - Energy Marketing & Trading and Other" above and Note 18 to the Financial Statements.

#### **2) Defined Benefits**

PPL and certain of its subsidiaries sponsor various defined benefit pension and other postretirement plans applicable to the majority of the employees of PPL and its subsidiaries. PPL and certain of its subsidiaries record an asset or liability to recognize the funded status of all defined benefit plans with an offsetting entry to OCI or regulatory assets for PPL Electric. Consequently, the funded status of all defined benefit plans is fully recognized on the Balance Sheets. See Note 12 to the Financial Statements for additional information about the plans and the accounting for defined benefits.

PPL makes certain assumptions regarding the valuation of benefit obligations and the performance of plan assets. When accounting for defined benefits, delayed recognition in earnings of differences between actual results and expected or estimated results is a *guiding principle*. Annual net periodic defined benefit costs are recorded in current earnings based on estimated results. Any differences between actual and estimated results are recorded in OCI or regulatory assets for PPL Electric. These amounts in AOCI or regulatory assets are amortized to income over future periods. The delayed recognition allows for a smoothed recognition of costs over the working lives of the employees who benefit under the plans. The primary assumptions are:

- **Discount Rate** - The discount rate is used in calculating the present value of benefits, which is based on projections of benefit payments to be made in the future. The objective in selecting the discount rate is to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments, would provide the necessary future cash flows to pay the accumulated benefits when due.
- **Expected Return on Plan Assets** - Management projects the long-term rates of return on plan assets based on historical performance, future expectations and periodic portfolio rebalancing among the diversified asset classes. These projected returns reduce the net benefit costs PPL records currently.
- **Rate of Compensation Increase** - Management projects employees' annual pay increases, which are used to project employees' pension benefits at retirement.
- **Health Care Cost Trend Rate** - Management projects the expected increases in the cost of health care.

In selecting a discount rate for its U.S. defined benefit plans, PPL starts with an analysis of the expected benefit payment stream for its

plans. This information is first matched against a spot-rate yield curve. A portfolio of 526 Aa-graded non-callable (or callable with make-whole provisions) bonds, with a total amount outstanding in excess of \$541 billion, serves as the base from which those with the lowest and highest yields are eliminated to develop the ultimate yield curve. The results of this analysis are considered together with other economic data and movements in various bond indices to determine the discount rate assumption. At December 31, 2009, PPL decreased the discount rate for its U.S. pension plans from 6.50% to 6.00% as a result of this assessment and decreased the discount rate for its other postretirement benefit plans from 6.45% to 5.81%.

A similar process is used to select the discount rate for the U.K. pension plans, which uses an iBoxx British pounds sterling denominated corporate bond index as its base. At December 31, 2009, PPL decreased the discount rate for the U.K. pension plans from 7.47% to 5.55% as a result of this assessment.

The expected long-term rates of return for PPL's U.S. defined benefit pension and other postretirement benefit plans have been developed using a best-estimate of expected returns, volatilities and correlations for each asset class. PPL management corroborates these rates with expected long-term rates of return calculated by its independent actuary, who uses a building block approach that begins with a risk-free rate of return with factors being added such as inflation, duration, credit spreads and equity risk. Each plan's specific asset allocation is also considered in developing a reasonable return assumption.

At December 31, 2009, PPL's expected return on plan assets remained at 8.00% for its U.S. pension plans and remained at 7.00% for its other postretirement benefit plans. The expected long-term rates of return for PPL's U.K. pension plans have been developed by WPD management with assistance from an independent actuary using a best-estimate of expected returns, volatilities and correlations for each asset class. For the U.K. plans, PPL's expected return on plan assets remained at 7.90% at December 31, 2009.

In selecting a rate of compensation increase, PPL considers past experience in light of movements in inflation rates. At December 31, 2009, PPL's rate of compensation increase remained at 4.75% for its U.S. plans. For the U.K. plans, PPL's rate of compensation increase remained at 4.00% at December 31, 2009.

In selecting health care cost trend rates, PPL considers past performance and forecasts of health care costs. At December 31, 2009, PPL's health care cost trend rates were 8.00% for 2010, gradually declining to 5.50% for 2016.

A variance in the assumptions listed above could have a significant impact on accrued defined benefit liabilities or assets, reported annual net periodic defined benefit costs and OCI or regulatory assets for PPL Electric. While the charts below reflect either an increase or decrease in each assumption, the inverse of this change would impact the accrued defined benefit liabilities or assets, reported annual net periodic defined benefit costs and OCI or regulatory assets for PPL Electric by a similar amount in the opposite direction. The sensitivities below reflect an evaluation of the change based solely on a change in that assumption and does not include income tax effects.

At December 31, 2009, PPL had recorded the following defined benefit plan liabilities:

Pension liabilities	\$	1,290
Other postretirement benefit liabilities		197

The following chart reflects the sensitivities in the December 31, 2009 Balance Sheet associated with a change in certain assumptions based on PPL's primary defined benefit plans.

Actuarial assumption	Change in assumption	Increase (Decrease)		
		Impact on defined benefit liabilities	Impact on OCI	Impact on regulatory assets
Discount Rate	(0.25)%	\$ 194	\$ (163)	\$ 31
Rate of Compensation Increase	0.25%	26	(21)	5
Health Care Cost Trend Rate (a)	1.0%	12	(8)	4

(a) Only impacts other postretirement benefits.

In 2009, PPL recognized net periodic defined benefit costs charged to operating expense of \$70 million. This amount represents a \$14 million increase from 2008. This increase in expense was primarily attributable to actual asset losses in 2008. As a result, the expected return on assets in 2009 was lower and amortization of gain/loss was impacted.

The following chart reflects the sensitivities in the 2009 Statement of Income (excluding income tax effects) associated with a change in certain assumptions based on PPL's primary defined benefit plans.

Actuarial assumption	Change in assumption	Impact on defined benefit costs
Discount Rate	(0.25)%	\$ 7
Expected Return on Plan Assets	(0.25)%	12
Rate of Compensation Increase	0.25%	3
Health Care Cost Trend Rate (a)	1.0%	2

(a) Only impacts other postretirement benefits.

### 3) Asset Impairment

PPL performs impairment analyses for long-lived assets that are subject to depreciation or amortization whenever events or changes in circumstances indicate that a long-lived asset's carrying value may not be recoverable. For these long-lived assets to be held and used, such events or changes in circumstances are:

- a significant decrease in the market price of an asset;
- a significant adverse change in the manner in which an asset is being used or in its physical condition;
- a significant adverse change in legal factors or in the business climate;
- an accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of an asset;
- a current-period operating or cash flow loss combined with a history of losses or a forecast that demonstrates continuing losses; or
- a current expectation that, more likely than not, an asset will be sold or otherwise disposed of before the end of its previously estimated useful life.

For a long-lived asset to be held and used, an impairment is recognized when the carrying amount of the asset is not recoverable and exceeds its fair value. The carrying amount is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. If the asset is impaired, an impairment loss is recorded to adjust the asset's carrying value to its estimated fair value. Management must make significant judgments to estimate future cash flows including the useful lives of long-lived assets, the fair value of the assets and management's intent to use the assets. PPL considers alternate courses of action to recover the carrying value of a long-lived asset, and uses estimated cash flows from the "most likely" alternative to assess impairment whenever one alternative is clearly the most likely outcome. If no alternative is clearly the most likely, then a probability-weighted approach is used taking into consideration estimated cash flows from the alternatives. For assets tested for impairment as of the balance sheet date, the estimates of future cash flows used in that test consider the likelihood of possible outcomes that existed at the balance sheet date, including the assessment of the likelihood of a future sale of the assets. That assessment is not revised based on events that occur after the balance sheet date. Changes in assumptions and estimates could result in significantly different results than those identified and recorded in the financial statements.

For a long-lived asset held for sale, an impairment exists when the carrying amount of the asset (disposal group) exceeds its fair value less cost to sell. If the asset (disposal group) is impaired, an impairment loss is recorded to adjust its carrying amount to its fair value less cost to sell. A gain is recognized for any subsequent increase in fair value less cost to sell, but not in excess of the cumulative impairment previously recognized.

In determining fair value, quoted market prices in active markets are the best evidence of fair value. However, when market prices are unavailable, PPL considers all valuation techniques appropriate in the circumstances and for which market participant inputs can be obtained. PPL has generally used discounted cash flows to estimate fair value, which incorporates market participant inputs when available. Discounted cash flows are calculated by estimating future cash flow streams and applying appropriate discount rates to determine the present value of the cash flow streams.

In 2009, PPL recorded impairments of certain long-lived assets. See Note 17 to the Financial Statements for a discussion of impairments related to certain sulfur dioxide emission allowances and the Long Island generation business.

PPL tests goodwill for impairment at the reporting unit level. PPL has determined its reporting units to be at or one level below its operating segments. PPL performs a goodwill impairment test annually or more frequently if events or changes in circumstances indicate that the carrying value of the reporting unit may be greater than the unit's fair value. Additionally, goodwill is tested for impairment after a portion of goodwill has been allocated to a business to be disposed of.

Goodwill is tested for impairment using a two-step approach. The first step of the goodwill impairment test compares the estimated fair value of a reporting unit with its carrying amount, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered impaired. If the carrying amount exceeds the estimated fair value of the reporting unit, the second step is performed to measure the amount of impairment loss, if any.

The second step requires a calculation of the implied fair value of goodwill. The implied fair value of goodwill is determined in the same manner as the amount of goodwill in a business combination. That is, the estimated fair value of a reporting unit is allocated to all of the assets and liabilities of that unit as if the reporting unit had been acquired in a business combination and the estimated fair value of the reporting unit was the price paid to acquire the reporting unit. The excess of the estimated fair value of a reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of goodwill. The implied fair value of the reporting unit's goodwill is then compared with the carrying amount of that goodwill. If the carrying amount exceeds the implied fair value, an impairment loss is recognized in an amount equal to that excess. The loss recognized cannot exceed the carrying amount of the reporting unit's goodwill.

In 2009, PPL was not required to impair any goodwill. Management primarily used discounted cash flows, which required significant assumptions, to estimate the fair value of each reporting unit. A decrease in the forecasted cash flows of 10%, or an increase of the discount rate by 25 basis points, would not have resulted in an impairment of goodwill.

Additionally, in 2009, PPL wrote off \$3 million of goodwill allocated to discontinued operations.

### 4) Loss Accruals

PPL accrues losses for the estimated impacts of various conditions, situations or circumstances involving uncertain or contingent future outcomes. For loss contingencies, the loss must be accrued if (1) information is available that indicates it is probable that a loss has been incurred, given the likelihood of the uncertain future events, and (2) the amount of the loss can be reasonably estimated. Accounting guidance defines "probable" as cases in which "the future event or events are likely to occur." PPL does not record the accrual of contingencies that might result in gains, unless recovery is assured. PPL continuously assesses potential loss contingencies for environmental remediation, litigation claims, regulatory penalties and other events.

The accounting aspects of estimated loss accruals include (1) the initial identification and recording of the loss, (2) the determination of triggering events for reducing a recorded loss accrual, and (3) the ongoing assessment as to whether a recorded loss accrual is sufficient. All three of these aspects require significant judgment by PPL's management. PPL uses its internal expertise and outside experts (such as lawyers and engineers), as necessary, to help estimate the probability that a loss has been incurred and the amount (or range) of the loss.

No new significant loss accruals were recorded in 2009. In 2008, significant judgment was required by PPL's management to perform an assessment of the contingency related to the Montana hydroelectric litigation.

In June 2008, PPL's management assessed the loss exposure related to the Montana hydroelectric litigation, given the June 2008 decision by the Montana First Judicial District Court (District Court). The District Court awarded compensation of approximately \$34 million for the years 2000 through 2006, and approximately \$6 million for 2007 as rent for the use of the State of Montana's streambeds by PPL Montana's hydroelectric facilities. The District Court also deferred the determination of compensation for 2008 and subsequent years to the Montana State Land Board (Land Board). In October 2008, PPL Montana filed an appeal of the decision to the Montana Supreme Court and a stay of judgment, including a stay of the Land Board's authority to assess compensation against PPL Montana for 2008 and future periods. Oral agreement of the case was held before the Montana Supreme Court in September 2009.

As part of the preparation of its 2009 financial statements, PPL's management reassessed the loss exposure for the Montana hydroelectric litigation. PPL's management concluded, based on its assessment and after consultations with its trial counsel, that it has meritorious arguments on appeal for the years 2000 through 2006. PPL assessed the likelihood of a loss for these years as reasonably possible. However, PPL Montana has not recorded a loss accrual for these years, as the likelihood of a loss was not deemed probable.

For 2007 and subsequent years, PPL's management believes that while it also has meritorious arguments, it is probable that its hydroelectric projects will be subject to annual estimated compensation ranging from \$3 million to \$6 million. Given that there was no single amount within that range more likely than any other, PPL Montana accrued \$3 million for each of the years 2007 through 2009 for a total of \$9 million. See Note 14 to the Financial Statements for additional information on this contingency.

PPL has identified certain other events that could give rise to a loss, but that do not meet the conditions for accrual. Such events are disclosed, but not recorded, when it is "reasonably possible" that a loss has been incurred. See Note 14 to the Financial Statements for disclosure of other potential loss contingencies that have not met the criteria for accrual.

When an estimated loss is accrued, PPL identifies, where applicable, the triggering events for subsequently reducing the loss accrual. The triggering events generally occur when the contingency has been resolved and the actual loss is incurred, or when the risk of loss has diminished or been eliminated. The following are some of the triggering events that provide for the reduction of certain recorded loss accruals:

- Allowances for uncollectible accounts are reduced when accounts are written off after prescribed collection procedures have been exhausted, a better estimate of the allowance is determined or underlying amounts are ultimately collected.
- Environmental and other litigation contingencies are reduced when the contingency is resolved and PPL makes actual payments, a better estimate of the loss is determined or the loss is no longer considered probable.

PPL reviews its loss accruals on a regular basis to assure that the recorded potential loss exposures are appropriate. This involves ongoing communication and analyses with internal and external legal counsel, engineers, operation management and other parties.

## 5) Asset Retirement Obligations

PPL is required to recognize a liability for legal obligations associated with the retirement of long-lived assets. The initial obligation should be measured at its estimated fair value. An equivalent amount should be recorded as an increase in the value of the capitalized asset and allocated to expense over the useful life of the asset. Until the obligation is settled, the liability should be increased, through the recognition of accretion expense in the income statement, for changes in the obligation due to the passage of time. A conditional ARO must be recognized when incurred if the fair value of the ARO can be reasonably estimated.

In determining AROs, management must make significant judgments and estimates to calculate fair value. Fair value is developed using an expected present value technique based on assumptions of market participants that considers estimated retirement costs in current period dollars that are inflated to the anticipated retirement date and then discounted back to the date the ARO was incurred. Changes in assumptions and estimates included within the calculations of the fair value of AROs could result in significantly different results than those identified and recorded in the financial statements. Estimated ARO costs and settlement dates, which affect the carrying value of various AROs and the related assets, are reviewed periodically to ensure that any material changes are incorporated into the latest estimate of the obligations.

At December 31, 2009, PPL had AROs totaling \$426 million recorded on the Balance Sheet, of which \$10 million is included in "Other current liabilities." Of the total amount, \$348 million, or 82%, relates to PPL's nuclear decommissioning ARO. The most significant assumptions

surrounding AROs are the forecasted retirement costs, the discount rates and the inflation rates. A variance in the forecasted retirement costs, the discount rates or the inflation rates could have a significant impact on the ARO liabilities.

The following chart reflects the sensitivities related to PPL's nuclear decommissioning ARO liability as of December 31, 2009, associated with change in these assumptions at the time of initial recognition. There is no significant change to the annual depreciation expense of the ARO asset or the annual accretion expense of the ARO liability as a result of changing the assumptions. The sensitivities below reflect an evaluation of the change based solely on a change in that assumption.

	<u>Change in Assumption</u>	<u>Impact on ARO Liability</u>
Retirement Cost	10%/(10)%	\$32/\$(32)
Discount Rate	0.25%/(0.25)%	\$(31)/\$34
Inflation Rate	0.25%/(0.25)%	\$41/\$(37)

## 6) Income Tax Uncertainties

Significant management judgment is required in developing PPL's provision for income taxes primarily due to the uncertainty related to tax positions taken or expected to be taken in tax returns and the determination of deferred tax assets, liabilities and valuation allowances.

Significant management judgment is required to determine the amount of benefit recognized related to an uncertain tax position. PPL evaluates its tax positions following a two-step process. The first step requires an entity to determine whether, based on the technical merits supporting a particular tax position, it is more likely than not (greater than a 50% chance) that the tax position will be sustained. This determination assumes that the relevant taxing authority will examine the tax position and is aware of all the relevant facts surrounding the tax position. The second step requires an entity to recognize in the financial statements the benefit of a tax position that meets the more-likely-than-not recognition criterion. The benefit recognized is measured at the largest amount of benefit that has a likelihood of realization, upon settlement, that exceeds 50%. PPL's management considers a number of factors in assessing the benefit to be recognized, including negotiation of a settlement.

On a quarterly basis, PPL reassesses its uncertain tax positions by considering information known at the reporting date. Based on management's assessment of new information, PPL may subsequently recognize a tax benefit for a previously unrecognized tax position, derecognize a previously recognized tax position, or re-measure the benefit of a previously recognized tax position. The amounts ultimately paid upon resolution of issues raised by taxing authorities may differ materially from the amounts accrued and may materially impact PPL's financial statements in the future.

The balance sheet classification of unrecognized tax benefits and the need for valuation allowances to reduce deferred tax assets also require significant management judgment. PPL classifies unrecognized tax benefits as current, to the extent management expects to settle an uncertain tax position, by payment or receipt of cash, within one year of the reporting date. Valuation allowances are initially recorded and reevaluated each reporting period by assessing the likelihood of the ultimate realization of a deferred tax asset. Management considers a number of factors in assessing the realization of a deferred tax asset, including the reversal of temporary differences, future taxable income and ongoing prudent and feasible tax planning strategies. Any tax planning strategy utilized in this assessment must meet the recognition and measurement criteria utilized by PPL to account for an uncertain tax positions. See Note 5 to the Financial Statements for the required disclosures.

At December 31, 2009, it was reasonably possible that during the next 12 months the total amount of unrecognized tax benefits could increase by as much as \$34 million or decrease by up to \$179 million for PPL. This change could result from subsequent recognition, derecognition and/or changes in the measurement of uncertain tax positions related to the creditability of foreign taxes, the timing and utilization of foreign tax credits and the related impact on alternative minimum tax and other credits, the timing and/or valuation of certain deductions, intercompany transactions and unitary filing groups. The events that could cause these changes are direct settlements with taxing authorities, litigation, legal or administrative guidance by relevant taxing authorities and the lapse of an applicable statute of limitation.

## 7) Regulatory Assets

PPL's domestic electricity delivery business is subject to cost-based rate-regulation. As a result, PPL is required to reflect the effects of regulatory actions in its financial statements. PPL records assets that result from the regulated ratemaking process that may not be recorded under GAAP for non-regulated entities. Regulatory assets generally represent incurred costs that have been deferred because such costs are probable of future recovery in regulated customer rates.

Management continually assesses whether the regulatory assets are probable of future recovery by considering factors such as changes in the applicable regulatory and political environments, the ability to recover costs through regulated rates, recent rate orders to other regulated entities, and the status of any pending or potential deregulation legislation. Based on this continual assessment, management believes the existing regulatory assets are probable of recovery. This assessment reflects the current political and regulatory climate at the state and federal levels, and is subject to change in the future. If future recovery of costs ceases to be probable, then asset write-offs would be required to be recognized in operating income. Additionally, the regulatory agencies can provide flexibility in the manner and timing of the depreciation of P&E and amortization of regulatory assets.

At December 31, 2009 and 2008, PPL had regulatory assets of \$531 million and \$763 million. All of PPL's regulatory assets are either currently being recovered under specific rate orders or represent amounts that will be recovered in future rates based upon established regulatory practices.

### **Other Information**

PPL's Audit Committee has approved the independent auditor to provide audit and audit-related services and other services permitted by Sarbanes-Oxley and SEC rules. The audit and audit-related services include services in connection with statutory and regulatory filings, reviews of offering documents and registration statements, and internal control reviews.

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## PPL ENERGY SUPPLY, LLC AND SUBSIDIARIES

### Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

#### Overview

PPL Energy Supply is an energy company with headquarters in Allentown, Pennsylvania. Refer to "Item 1. Business - Background" for descriptions of its reportable segments, which are Supply and International Delivery. Through its subsidiaries, PPL Energy Supply is primarily engaged in the generation and marketing of electricity in two key markets - the northeastern and western U.S. - and in the delivery of electricity in the U.K. PPL Energy Supply's overall strategy is to achieve disciplined growth in energy supply margins while limiting volatility in both cash flows and earnings and to achieve stable, long-term growth in its regulated international electricity delivery business through efficient operations and strong customer and regulatory relations. More specifically, PPL Energy Supply's strategy for its electricity generation and marketing business is to match energy supply with load, or customer demand, under contracts of varying lengths with creditworthy counterparties to capture profits while effectively managing exposure to energy and fuel price volatility, counterparty credit risk and operational risk. PPL Energy Supply's strategy for its U.K. electricity delivery business is to own and operate this business at the most efficient cost while maintaining high quality customer service and reliability.

PPL Energy Supply faces several risks in its supply business, principally electricity and capacity wholesale price risk, fuel supply and price risk, electricity and fuel basis risk, power plant performance, evolving regulatory frameworks and counterparty credit risk. PPL Energy Supply attempts to manage these risks through various means. For instance, PPL Energy Supply operates a portfolio of generation assets that is diversified as to geography, fuel source, cost structure and operating characteristics. PPL Energy Supply expects to expand its generation capacity over the next several years through power uprates at certain of its existing power plants, and is continually evaluating the potential construction of new plants and the potential acquisition of existing plants or businesses. PPL Energy Supply is and will continue to remain focused on the operating efficiency and availability of its existing and any newly constructed or acquired power plants.

In addition, PPL Energy Supply has executed and continues to pursue contracts of varying lengths for energy sales and fuel supply, while using other means to mitigate risks associated with adverse changes in the difference, or margin, between the cost to produce electricity and the price at which PPL Energy Supply sells it. PPL Energy Supply's future profitability will be affected by prevailing market conditions and whether PPL Energy Supply decides to, or is able to, continue to enter into long-term or intermediate-term power sales and fuel purchase agreements or renew its existing agreements. Currently, PPL Energy Supply's commitments for energy sales are satisfied through its own generation assets and supply purchased from third parties. PPL Energy Supply markets and trades around its physical portfolio of generating assets through integrated generation, marketing and trading functions.

PPL Energy Supply has adopted financial and operational risk management programs that, among other things, are designed to monitor and manage its exposure to earnings and cash flow volatility related to changes in energy and fuel prices, interest rates, foreign currency exchange rates, counterparty credit quality and the operating performance of its generating units.

The principal challenge that PPL Energy Supply faces in its international electricity delivery business is to maintain high quality customer service and reliability in a cost-effective manner. PPL Energy Supply's international electricity delivery business is rate-regulated. Accordingly, the business is subject to regulatory risk with respect to the costs that may not be recovered and investment returns that may not be collected through customer rates.

PPL Energy Supply faces additional financial risks in conducting U.K. operations, such as fluctuations in foreign currency exchange rates and the effect these rates have on the conversion of U.K. earnings and cash flows to U.S. dollars. PPL Energy Supply attempts to manage these financial risks through its risk management programs.

In order to manage financing costs and access to credit markets, a key objective for PPL Energy Supply's business as a whole is to maintain a strong credit profile. PPL Energy Supply continually focuses on maintaining an appropriate capital structure and liquidity position.

See "Item 1A. Risk Factors" for more information concerning these and other material risks PPL Energy Supply faces in its businesses.

In May 2009, PPL Generation signed a definitive agreement to sell its Long Island generation business and related tolling agreements and expects the sale to close on or about February 26, 2010. In November 2009, PPL Maine completed the sale of the majority of its hydroelectric generation business. These businesses are included in the Supply segment. In 2007, PPL Energy Supply sold its regulated electricity delivery businesses in Latin America, which were included in the International Delivery segment. See Note 9 to the Financial Statements for additional information.

The purpose of "Management's Discussion and Analysis of Financial Condition and Results of Operations" is to provide information concerning PPL Energy Supply's performance in implementing the strategies and managing the risks and challenges mentioned above. Specifically:

- "Results of Operations" provides an overview of PPL Energy Supply's operating results in 2009, 2008 and 2007, including a review of earnings, with details of results by reportable segment. It also provides a brief outlook for 2010.
- "Financial Condition - Liquidity and Capital Resources" provides an analysis of PPL Energy Supply's liquidity position and credit profile, including its sources of cash (including bank credit facilities and sources of operating cash flow) and uses of cash (including contractual obligations and capital expenditure requirements) and the key risks and uncertainties that impact PPL Energy Supply's past and future liquidity position and financial condition. This subsection also includes a listing and discussion of PPL Energy Supply's current credit

ratings.

- "Financial Condition - Risk Management - Energy Marketing & Trading and Other" provides an explanation of PPL Energy Supply's risk management programs relating to market risk and credit risk.
- "Application of Critical Accounting Policies" provides an overview of the accounting policies that are particularly important to the results of operations and financial condition of PPL Energy Supply and that require its management to make significant estimates, assumptions and other judgments.

The information provided in this Item 7 should be read in conjunction with PPL Energy Supply's Consolidated Financial Statements and the accompanying Notes.

Terms and abbreviations are explained in the glossary. Dollars are in millions unless otherwise noted.

### **Customer Choice - End of Transition Period**

In 1996, the Customer Choice Act was enacted to restructure Pennsylvania's electric utility industry in order to create retail access to a competitive market for generation of electricity. The Customer Choice Act required each Pennsylvania electric utility, to file a restructuring plan to "unbundle" its rates into separate generation, transmission and distribution components and to permit its customers to directly access alternate suppliers of electricity. Under the Customer Choice Act, regulated utilities were required to act as a PLR. As part of a settlement approved by the PUC, PPL EnergyPlus and PPL Electric, a PPL EnergyPlus affiliate, entered into full requirements energy supply agreements at predetermined "capped" rates through 2009. In addition, the PUC authorized recovery of approximately \$2.97 billion of competitive transition or "stranded" costs (generation-related costs that might not otherwise be recovered in a competitive market) from customers during an 11-year transition period. For PPL Electric, this transition period ended on December 31, 2009.

With the expiration of the long-term power purchase agreements between PPL Electric and PPL EnergyPlus, PPL EnergyPlus now has multiple options as to how, and to whom, it sells the electricity produced by PPL Energy Supply's generation plants. These sales are based on prevailing market rates, as compared to pre-determined capped rates under the expired supply agreements with PPL Electric. PPL EnergyPlus has entered into various wholesale and retail contracts to sell this power and at this time has hedged almost 100% of expected 2010 baseload generation output. The expiration of the long-term supply agreements with PPL Electric also provides PPL Energy Supply the ability to adjust its exposure to fluctuations in demand that existed with supplying PPL Electric's PLR load. Entry of new generation suppliers into the Pennsylvania marketplace provides PPL Energy Supply the ability to provide generation supply to additional wholesale customers. Overall, these changes and the resulting level of hedged electricity prices are expected to have a positive impact on the financial condition, operating results and cash flows of PPL Energy Supply.

PPL Electric's customers are no longer funding contributions to Susquehanna's NDT funds. PPL will continue to manage the NDT funds until the PPL Susquehanna plant is decommissioned. If the balance of the NDT funds is not adequate to cover decommissioning costs, PPL Susquehanna will be responsible to fund 90% of the shortfall. The Susquehanna nuclear units currently are licensed to operate until 2042 and 2044.

### **Market Events**

In 2008, conditions in the financial markets became disruptive to the processes of managing credit risk, responding to liquidity needs, measuring derivatives and other financial instruments at fair value, and managing market risk. Bank credit capacity was reduced and the cost of renewing or establishing new credit facilities increased, thereby introducing uncertainties as to PPL Energy Supply's ability to enter into long-term energy commitments or reliably estimate the longer-term cost and availability of credit. In general, bank credit capacity has increased from the significantly constrained levels of 2008 and early 2009. In addition, the cost of renewing or establishing new credit facilities has improved when compared with the 2008 and early 2009 periods.

### Commodity Price Risk

The contraction in wholesale energy market liquidity and accompanying decline in wholesale energy prices due to conditions in the financial and commodity markets significantly impacted PPL Energy Supply's earnings during the second half of 2008 and the first half of 2009. See "Statement of Income Analysis - Domestic Gross Energy Margins - Domestic Gross Energy Margins By Region" for further discussion.

### Credit Risk

Credit risk is the risk that PPL Energy Supply would incur a loss as a result of nonperformance by counterparties of their contractual obligations. PPL Energy Supply maintains credit policies and procedures to limit counterparty credit risk. Conditions in the financial and commodity markets have generally increased PPL Energy Supply's exposure to credit risk. See Notes 15, 17 and 18 to the Financial Statements, and "Risk Management - Energy Marketing & Trading and Other - Credit Risk" for more information on credit risk.

### Liquidity Risk

PPL Energy Supply expects to continue to have access to adequate sources of liquidity through operating cash flows, cash and cash equivalents, credit facilities and, from time to time, the issuance of capital market securities. PPL Energy Supply's ability to access capital markets may be impacted by conditions in the overall financial and capital markets, as well as conditions specific to the utility sector. See "Financial Condition - Liquidity and Capital Resources" for an expanded discussion of PPL Energy Supply's liquidity position and a discussion

of its forecasted sources of cash.

### Valuations in Inactive Markets

Conditions in the financial markets have generally made it difficult to determine the fair value of certain assets and liabilities in inactive markets. Management has reviewed the activity in the energy and financial markets in which PPL Energy Supply transacts, concluding that all of these markets were active at December 31, 2009, with the exception of the market for auction rate securities. See Notes 17 and 21 to the Financial Statements and "Financial Condition - Liquidity and Capital Resources - Auction Rate Securities" for a discussion of these investments.

### Securities Price Risk

Declines in the market price of debt and equity securities result in unrealized losses that reduce the asset values of PPL Energy Supply's investments in its defined benefit plans and NDT funds. Both the defined benefit plans and the NDT funds earned positive returns in the second half of 2009, thereby recovering a portion of the negative returns incurred in 2008 and the first quarter of 2009. PPL Energy Supply actively monitors the performance of the investments held in its defined benefit plans and NDT funds and periodically reviews the funds' investment allocations. See "Financial Condition - Risk Management - Energy Marketing & Trading and Other - NDT Funds - Securities Price Risk" for additional information on securities price risk.

PPL Energy Supply's subsidiaries sponsor various defined benefit plans and participate in and are allocated costs from defined benefit plans sponsored by PPL. Determination of the funded status of defined benefit plans, contribution requirements and net periodic defined benefit costs for future years are subject to changes in various assumptions, in addition to the actual performance of the assets in the plans. See "Application of Critical Accounting Policies - Defined Benefits" for a discussion of the assumptions and sensitivities regarding those assumptions.

### The Economic Stimulus Package

The Economic Stimulus Package was intended to stimulate the U.S. economy through federal tax relief, expansion of unemployment benefits and other social stimulus provisions, domestic spending for education, health care and infrastructure, including the energy sector. A portion of the benefits included in the Economic Stimulus Package are offered in the form of loan fee reductions, expanded loan guarantees and secondary market incentives, including delayed recognition for tax purposes of income related to the cancellation of certain types of debt. See "Financial Condition - Liquidity and Capital Resources" for a discussion of the applicability to the purchase of notes by PPL Energy Supply.

Funds from the Economic Stimulus Package have been allocated to various federal agencies, such as the DOE, and provided to state agencies through block grants. The DOE has made awards of the funds for smart grid, efficiency-related and renewable energy programs. The Commonwealth of Pennsylvania has also made awards for funding certain energy projects, including solar projects. As discussed in Note 8 to the Financial Statements, PPL Energy Supply has reconsidered and decided to pursue its Holtwood expansion project in view of the tax incentives and potential loan guarantees for renewable energy projects contained in the Economic Stimulus Package. PPL Energy Supply has applied for DOE loan guarantees for the Holtwood expansion project and, through its subsidiary PPL Montana, for the Rainbow redevelopment project.

## Results of Operations

PPL Energy Supply presents tables analyzing changes in amounts between periods within "Segment Results" and "Statement of Income Analysis" on a constant U.K. foreign currency exchange rate basis, where applicable, in order to isolate the impact of the change in the exchange rate on the item being explained. Results computed on a constant U.K. foreign currency exchange rate basis are calculated by translating current year results at the prior year weighted-average foreign currency exchange rate.

### **Earnings**

Net income attributable to PPL Energy Supply was:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
\$	246	\$ 768	\$ 1,205

The changes in net income attributable to PPL Energy Supply from year to year were, in part, due to several special items that management considers significant. Details of these special items are provided within the review of each segment's earnings.

The year-to-year changes in significant earnings components, including domestic gross energy margins by region and significant income statement line items, are explained in the "Statement of Income Analysis."

PPL Energy Supply's earnings beyond 2009 are subject to various risks and uncertainties. See "Forward-Looking Information," "Item 1A. Risk Factors," the rest of this Item 7 and Note 14 to the Financial Statements for a discussion of the risks, uncertainties and factors that may impact PPL Energy Supply's future earnings.

### **Segment Results**

Net income attributable to PPL Energy Supply by segment was:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Supply	\$ 3	\$ 478	\$ 595
International Delivery	243	290	610
Total	<u>\$ 246</u>	<u>\$ 768</u>	<u>\$ 1,205</u>

Supply Segment

The Supply segment primarily consists of the domestic energy marketing and trading activities, as well as the generation and development operations of PPL Energy Supply. In December 2009, PPL Maine sold its 8.33% ownership interest in Wyman Unit 4. In November 2009, PPL Maine completed the sale of the majority of its hydroelectric generation business. In May 2009, PPL Generation signed a definitive agreement to sell its Long Island generation business and expects the sale to close on or about February 26, 2010. In August 2007, PPL Energy Supply completed the sale of its domestic telecommunication operations. See Notes 8 and 9 to the Financial Statements for additional information.

The Supply segment results reflect the classification of the Long Island generation business, the majority of the Maine hydroelectric generation business, and the 8.33% ownership interest in Wyman Unit 4, as Discontinued Operations. See Note 9 to the Financial Statements for additional information.

Supply segment net income attributable to PPL Energy Supply was:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Energy revenues (a)	\$ 5,037	\$ 5,200	\$ 3,389
Energy-related businesses	379	478	723
Total operating revenues	<u>5,416</u>	<u>5,678</u>	<u>4,112</u>
Fuel and energy purchases (a)	3,679	3,215	1,575
Other operation and maintenance	927	884	753
Depreciation	210	180	152
Taxes, other than income	29	20	31
Energy-related businesses	372	464	740
Total operating expenses	<u>5,217</u>	<u>4,763</u>	<u>3,251</u>
Other Income - net (b)	48	45	83
Other-Than-Temporary Impairments	18	36	3
Interest Expense (c)	185	169	106
Income Taxes	27	290	249
Income (Loss) from Discontinued Operations	<u>(13)</u>	<u>15</u>	<u>12</u>
Net Income	4	480	598
Net Income Attributable to Noncontrolling Interests	1	2	3
Net Income Attributable to PPL Energy Supply	<u>\$ 3</u>	<u>\$ 478</u>	<u>\$ 595</u>

(a) Includes impact from energy-related economic activity. See "Commodity Price Risk (Non-trading) - Economic Activity" in Note 18 to the Financial Statements for additional information.

(b) Includes interest income from affiliates.

(c) Includes interest expense with affiliate.

The after-tax changes in net income attributable to PPL Energy Supply between these periods were due to the following factors.

	<u>2009 vs. 2008</u>	<u>2008 vs. 2007</u>
Eastern U.S. non-trading margins	\$ (3)	\$ (62)
Western U.S. non-trading margins	20	5
Net energy trading margins	81	(95)
Energy-related businesses	(4)	(4)
Other operation and maintenance	(32)	12
Depreciation	(18)	(16)
Taxes, other than income	(5)	6
Other income - net (a)	(4)	(21)
Interest expense (b)	(9)	(38)
Income taxes	(24)	(61)
Discontinued operations (Note 9)	(9)	3
Other	1	2
Special items	<u>(469)</u>	<u>152</u>

\$ (475)      \$ (117)

- (a) Includes interest income from affiliates.  
 (b) Includes interest expense with affiliate.

- See "Domestic Gross Energy Margins" for an explanation of non-trading margins and net energy trading margins.
- Other operation and maintenance expenses increased in 2009 compared with 2008, primarily due to increased payroll-related costs, higher contractor-related costs and other costs at PPL Energy Supply's generation plants.
- Depreciation expense increased in 2009 compared with 2008, primarily due to the scrubbers at Brunner Island and Montour and the portions of the Susquehanna uprate projects that were placed in service in 2008 and 2009.

Depreciation expense increased in 2008 compared with 2007, primarily due to the Montour scrubbers and the Susquehanna uprate project that were placed in service in 2008.

- Other income - net decreased in 2008 compared with 2007, primarily due to a decrease in earnings on nuclear plant decommissioning trust investments and lower gains on sales of real estate.
- Interest expense increased in 2008 compared with 2007, primarily due to increased interest on long-term debt resulting from new issuances.
- Income taxes increased in 2009 compared with 2008, in part due to lower domestic manufacturing deductions in 2009.

Income taxes increased in 2008 compared with 2007, primarily due to the loss of synfuel tax credits as the projects ceased operation at the end of 2007.

- Special items decreased in 2009 compared with 2008, primarily due to a \$476 million after-tax change in energy-related economic activity. The change is primarily the result of certain power and gas cash flow hedges failing hedge effectiveness testing in the third and fourth quarters of 2008, as well as the first quarter of 2009. Hedge accounting is not permitted for the quarter in which this occurs and, accordingly, the entire change in fair value for the periods that failed was recorded to the income statement. However, these transactions were not redesignated as hedges, as prospective regression analysis demonstrated that these hedges are expected to be highly effective over their term. For 2008, an after-tax gain of \$298 million was recognized in earnings as a result of these hedge failures. During the second, third and fourth quarters of 2009, fewer power and gas cash flow hedges failed hedge effectiveness testing; therefore, a portion of the previously recognized unrealized gains recorded in the second half of 2008 and the first quarter of 2009 associated with these hedges were reversed. For 2009, after-tax losses of \$215 million were recognized in earnings.

The following after-tax amounts, which management considers special items, also impacted the Supply segment's earnings.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Energy-related economic activity (Note 18)	\$ (225)	\$ 251	\$ 32
Sales of assets			
Long Island generation business (a)	(33)		
Interest in Wyman Unit 4 (Note 9)	(4)		
Majority of Maine hydroelectric generation business (Note 9)	22		
Domestic telecommunication operations (Note 8)			(23)
Impairments			
Impacts from emission allowances (b)	(19)	(25)	
Other asset impairments (c)	(4)	(15)	
Adjustments - NDT investments (d)		(17)	
Transmission rights (e)			(13)
Workforce reduction (Note 12)	(6)	(1)	(4)
Other			
Change in tax accounting method related to repairs (Note 5)	(21)		
Montana hydroelectric litigation (Note 14)	(3)		
Synthetic fuel tax adjustment (Note 14)		(13)	
Montana basin seepage litigation (Note 14)		(5)	
Off-site remediation of ash basin leak (Note 14)		1	
Settlement of Wallingford cost-based rates (f)			33
PJM billing dispute			(1)
Total	<u>\$ (293)</u>	<u>\$ 176</u>	<u>\$ 24</u>

- ) Consists primarily of the initial impairment charge recorded in June 2009 when this business was classified as held for sale. See Note 9 to the Financial Statements for additional information on the anticipated sale.  
 (b) 2009 primarily consists of a pre-tax charge of \$37 million related to sulfur dioxide emission allowances. See Note 17 to the Financial Statements for additional information.

2008 consists of charges related to annual nitrogen oxide allowances and put options. See Note 14 to the Financial Statements for additional information.

- (c) 2008 primarily consists of a pre-tax charge of \$22 million related to the cancellation of the Holtwood hydroelectric expansion project. See Note 8 to the Financial Statements for additional information.
- d) Represents other-than-temporary impairment charges on securities, including reversals of previous impairments when previously impaired securities were sold.
- (e) See "Other Operation and Maintenance" for more information on the \$23 million pre-tax impairment recorded in 2007.
- (f) In 2003, PPL Wallingford and PPL EnergyPlus sought from the FERC cost-based payments based upon the RMR status of four units at the Wallingford, Connecticut generating facility. In 2007, as a result of a settlement agreement, PPL Energy Supply recognized \$55 million of revenue and \$4 million of interest income.

#### 2010 Outlook

Excluding special items, PPL Energy Supply projects higher earnings from its Supply segment in 2010 compared with 2009, due to growth in energy margins. The forecast for growth in energy margins is based on hedged power and fuel prices as well as established capacity prices in PJM. These positive factors are expected to be partially offset by higher depreciation, financing costs and operation and maintenance expenses.

#### International Delivery Segment

The International Delivery segment consists primarily of the electricity distribution operations in the U.K. In 2007, PPL Energy Supply completed the sale of its Latin American businesses. In 2008, the International Delivery segment recognized income tax benefits and miscellaneous expenses in Discontinued Operations in connection with the dissolution of certain Latin American holding companies. In 2009, the International Delivery segment recognized \$24 million of income tax expense in Discontinued Operations related to a correction of the calculation of tax bases of the Latin American businesses sold in 2007. See Note 9 to the Financial Statements for additional information.

The International Delivery segment results reflect the classification of its Latin American businesses as Discontinued Operations.

International Delivery segment net income attributable to PPL Energy Supply was:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Utility revenues	\$ 684	\$ 824	\$ 863
Energy-related businesses	32	33	37
Total operating revenues	<u>716</u>	<u>857</u>	<u>900</u>
Other operation and maintenance	140	186	252
Depreciation	115	134	147
Taxes, other than income	57	66	67
Energy-related businesses	16	14	17
Total operating expenses	<u>328</u>	<u>400</u>	<u>483</u>
Other Income - net	(11)	17	26
Interest Expense	87	144	183
Income Taxes	20	45	(43)
Income (Loss) from Discontinued Operations	<u>(27)</u>	<u>5</u>	<u>313</u>
Net Income	243	290	616
Net Income Attributable to Noncontrolling Interests			6
Net Income Attributable to PPL Energy Supply	<u>\$ 243</u>	<u>\$ 290</u>	<u>\$ 610</u>

The after-tax changes in net income attributable to PPL Energy Supply between these periods were due to the following factors.

	<u>2009 vs. 2008</u>	<u>2008 vs. 2007</u>
U.K.		
Delivery margins	\$ 17	\$ 12
Other operating expenses	7	22
Other income – net	(4)	(7)
Depreciation	(4)	4
Interest expense	28	5
Income taxes	24	24
Foreign currency exchange rates	(69)	(14)
Gain on transfer of equity investment		(5)
Other	(4)	(3)
Discontinued Operations (Note 9)	(5)	(49)
U.S. interest expense		17
U.S. income taxes	1	(32)
Gain (loss) on economic hedges (Note 15)	(12)	10
Other	2	6
Special items	<u>(28)</u>	<u>(310)</u>

\$ (47)      \$ (320)

- Lower U.K. other operating expenses in 2008 compared with 2007, were primarily due to lower compensation and lower pension costs.

Lower U.K. interest expense in 2009 compared with 2008, was primarily due to lower inflation rates on U.K. Index-linked Senior Unsecured Notes and lower debt balances.

- Lower U.K. income taxes in 2009 compared with 2008, were primarily due to HMRC's determination related to the valuation of a business activity sold in 1999 and to the deductibility of foreign currency exchange losses, partially offset by the items in 2008 mentioned below.

Lower U.K. income taxes in 2008 compared with 2007, were primarily due to HMRC's determination related to deductibility of imputed interest on a loan from Hyder and a change in tax law that included the phase-out of tax depreciation on industrial buildings over a four-year period.

- Changes in foreign currency exchange rates negatively impacted U.K. earnings for both periods. The weighted-average exchange rates for the British pound sterling were approximately \$1.53 in 2009, \$1.91 in 2008 and \$2.00 in 2007.
- Higher U.S. income taxes in 2008 compared with 2007, was primarily due to the change in a U.S. income tax reserve resulting from the lapse in 2007 of an applicable statute of limitations.

The following after-tax amounts, which management considers special items, also impacted the International Delivery segment's earnings.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Foreign currency-related economic hedges - unrealized impacts (Note 18)	\$ 1		
Sales of assets			
Latin American businesses (Note 9)	(27)		\$ 259
Impairments	(1)		
Workforce reduction (Note 12)	(2)	\$ (1)	(4)
Other			
Change in U.K. tax rate (Note 5)			54
<b>Total</b>	<u>\$ (29)</u>	<u>\$ (1)</u>	<u>\$ 309</u>

#### 2010 Outlook

Excluding special items, PPL Energy Supply projects lower earnings from its International Delivery segment in 2010 compared with 2009, as a result of higher income taxes, higher operation and maintenance expenses and higher financing costs. These negative factors are expected to be partially offset by higher electricity delivery margins and a more favorable currency exchange rate.

In December 2009, Ofgem completed its rate review for the five-year period from April 1, 2010 through March 31, 2015. Ofgem allowed WPD an average increase in total revenues, before inflationary adjustments, of 6.9% in each of the five years. The revenue increase includes reimbursement to electricity distributors for higher operating and capital costs to be incurred. Also, Ofgem set the weighted average cost of capital at 4.7%, which includes pre-tax debt and post-tax equity costs and excludes adjustments for inflation, for all distribution companies. This is a 0.8% decrease from the previous regulatory period. Additionally, Ofgem has established strong incentive mechanisms to provide companies significant opportunities to enhance overall returns by improving network efficiency, reliability or customer service.

#### Statement of Income Analysis --

##### Domestic Gross Energy Margins

##### Non-GAAP Financial Measure

The following discussion includes financial information prepared in accordance with GAAP, as well as a non-GAAP financial measure, "Domestic Gross Energy Margins." The presentation of "Domestic Gross Energy Margins" is intended to supplement the investor's understanding of PPL Energy Supply's domestic non-trading and trading activities by combining applicable income statement line items and related adjustments to calculate a single financial measure. PPL Energy Supply believes that "Domestic Gross Energy Margins" are useful and meaningful to investors because they provide them with the results of PPL Energy Supply's domestic non-trading and trading activities as another criterion in making their investment decisions. PPL Energy Supply's management also uses "Domestic Gross Energy Margins" in measuring certain corporate performance goals used in determining variable compensation. Other companies may use different measures to present the results of their non-trading and trading activities. Additionally, "Domestic Gross Energy Margins" are not intended to replace "Operating Income," which is determined in accordance with GAAP, as an indicator of overall operating performance. The following table provides a reconciliation between "Operating Income" and "Domestic Gross Energy Margins" as defined by PPL Energy Supply.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Operating Income (a)	\$ 587	\$ 1,372	\$ 1,278

Adjustments:			
Utility (a)	(684)	(824)	(863)
Energy-related businesses, net (b)	(23)	(33)	(3)
Other operation and maintenance (a)	1,067	1,070	1,005
Depreciation (a)	325	314	299
Taxes, other than income (a)	86	86	98
Revenue adjustments (c)	293	(1,032)	223
Expense adjustments (c)	80	611	(213)
Domestic gross energy margins	<u>\$ 1,731</u>	<u>\$ 1,564</u>	<u>\$ 1,824</u>

(a) As reported on the Statements of Income.

(b) Amount represents the net of "Energy-related businesses" revenue and expense as reported on the Statements of Income.

(c) The components of these adjustments are detailed in the tables below.

The following tables provide the income statement line items and other adjustments that comprise domestic gross energy margins.

	<u>2009</u>	<u>2008</u>	<u>Change</u>
Revenue			
Wholesale energy marketing (a)	\$ 3,062	\$ 3,344	\$ (282)
Wholesale energy marketing to affiliate (a)	1,806	1,826	(20)
Unregulated retail electric and gas (a)	152	151	1
Net energy trading margins (a)	17	(121)	138
Revenue adjustments (b)			
Miscellaneous wholesale energy marketing to affiliate	(12)	(14)	2
Impact from energy-related economic activity (c)	274	(1,061)	1,335
Gains from sale of emission allowances (d)	2	6	(4)
Revenues from Supply segment discontinued operations (e)	29	37	(8)
Total revenue adjustments	<u>293</u>	<u>(1,032)</u>	<u>1,325</u>
	<u>5,330</u>	<u>4,168</u>	<u>1,162</u>

Expense			
Fuel (a)	931	1,084	(153)
Energy purchases (a)	2,678	2,023	655
Energy purchases from affiliate (a)	70	108	(38)
Expense adjustments (b)			
Impact from energy-related economic activity (c)	(109)	(632)	523
Other	29	21	8
Total expense adjustments	<u>(80)</u>	<u>(611)</u>	<u>531</u>
	<u>3,599</u>	<u>2,604</u>	<u>995</u>
Domestic gross energy margins	<u>\$ 1,731</u>	<u>\$ 1,564</u>	<u>\$ 167</u>

	<u>2008</u>	<u>2007</u>	<u>Change</u>
Revenue			
Wholesale energy marketing (a)	\$ 3,344	\$ 1,436	\$ 1,908
Wholesale energy marketing to affiliate (a)	1,826	1,810	16
Unregulated retail electric and gas (a)	151	102	49
Net energy trading margins (a)	(121)	41	(162)
Revenue adjustments (b)			
Miscellaneous wholesale energy marketing to affiliate	(14)	(15)	1
Impact from energy-related economic activity (c)	(1,061)	145	(1,206)
Gains from sale of emission allowances (d)	6	109	(103)
RMR revenues		(52)	52
Revenues from Supply segment discontinued operations (e)	37	36	1
Total revenue adjustments	<u>(1,032)</u>	<u>223</u>	<u>(1,255)</u>
	<u>4,168</u>	<u>3,612</u>	<u>556</u>
Expense			
Fuel (a)	1,084	890	194
Energy purchases (a)	2,023	529	1,494
Energy purchases from affiliate (a)	108	156	(48)
Expense adjustments (b)			
Impact from energy-related economic activity (c)	(632)	200	(832)
Other	21	13	8
Total expense adjustments	<u>(611)</u>	<u>213</u>	<u>(824)</u>
	<u>2,604</u>	<u>1,788</u>	<u>816</u>
Domestic gross energy margins	<u>\$ 1,564</u>	<u>\$ 1,824</u>	<u>\$ (260)</u>



- (a) As reported on the Statements of Income.
- (b) To include/exclude the impact of any revenues and expenses not associated with domestic gross energy margins, consistent with the way management reviews domestic gross energy margins internally.
- (c) See Note 18 to the Financial Statements for additional information regarding economic activity.
  - 1) Included in "Other operation and maintenance" on the Statements of Income.
  - 2) Represents revenues associated with the Long Island generation business and the majority of the Maine hydroelectric generation business. See Note 9 to the Financial Statements for additional information.

#### Domestic Gross Energy Margins By Region

Domestic gross energy margins are generated through PPL Energy Supply's non-trading and trading activities. PPL Energy Supply manages its non-trading energy business on a geographic basis that is aligned with its generation assets.

	<u>2009</u>	<u>2008</u>	<u>Change</u>
Non-trading			
Eastern U.S.	\$ 1,391	\$ 1,396	\$ (5)
Western U.S.	323	289	34
Net energy trading	<u>17</u>	<u>(121)</u>	<u>138</u>
Domestic gross energy margins	<u>\$ 1,731</u>	<u>\$ 1,564</u>	<u>\$ 167</u>

	<u>2008</u>	<u>2007</u>	<u>Change</u>
Non-trading			
Eastern U.S.	\$ 1,396	\$ 1,502	\$ (106)
Western U.S.	289	281	8
Net energy trading	<u>(121)</u>	<u>41</u>	<u>(162)</u>
Domestic gross energy margins	<u>\$ 1,564</u>	<u>\$ 1,824</u>	<u>\$ (260)</u>

#### *Eastern U.S.*

Eastern U.S. non-trading margins were \$5 million lower in 2009 compared with 2008. This decrease was primarily due to lower margins on full-requirement sales contracts resulting from mild weather, decreased demand, and customer migration. Also contributing to the decrease were higher average baseload generation fuel costs of 7%, primarily due to higher coal prices. Partially offsetting these lower margins were net gains resulting from the settlement of economic positions associated with rebalancing PPL Energy Supply's portfolios to better align them with current strategies, higher capacity revenue, higher baseload generation output due to unplanned major outages in 2008, and a 2.2% increase in the PLR sales prices in accordance with the PUC Final Order.

Eastern U.S. non-trading margins were \$106 million lower in 2008 compared with 2007. This decrease was primarily due to higher fuel costs, up 16%, primarily due to higher coal prices. Also contributing to the decrease was lower baseload generation, down 4%, primarily due to the unplanned outages at the eastern coal-fired units and retirement of the Martins Creek coal-fired units in September 2007. Partially offsetting these lower margins were higher margins from the hedged sale of generation in the wholesale market and a 1.4% increase in PLR sales prices in accordance with the PUC Final Order.

#### *Western U.S.*

Western U.S. non-trading margins were \$34 million higher in 2009 compared with 2008. This increase was primarily due to higher wholesale volumes of 6% and increased generation from the hydroelectric units of 5%.

Western U.S. non-trading margins were \$8 million higher in 2008 compared with 2007. This increase was primarily due to increased generation from the hydroelectric units of 2%.

#### *Net Energy Trading*

PPL Energy Supply enters into energy contracts to take advantage of market opportunities. As a result, PPL Energy Supply may at times create a net open position in its portfolio that could result in significant losses if prices do not move in the manner or direction anticipated. However, these trading activities are subject to risk management program limits that are designed to protect PPL Energy Supply from undue financial loss. The margins from these trading activities are reflected in the Statements of Income as "Net energy trading margins." These physical and financial contracts cover trading activity associated with electricity, emission allowances, uranium, FTRs, natural gas, and oil.

Net energy trading margins increased by \$138 million in 2009 compared with 2008. This increase consisted of \$215 million of higher unrealized margins partially offset by \$77 million of lower realized margins. These changes were primarily due to increased margins in the power, gas and oil trading positions resulting from unrealized trading losses in 2008 due to a dramatic decline in energy prices and a severe contraction of liquidity in the wholesale power markets.

Net energy trading margins decreased by \$162 million in 2008 compared with 2007. This decrease consists of \$135 million of lower unrealized margins and \$27 million of lower realized margins, both driven by significant decreases in power and gas prices in the second half of 2008.

## Utility Revenues

The changes in utility revenues were attributable to:

	<u>2009 vs. 2008</u>	<u>2008 vs. 2007</u>
U.K. foreign currency exchange rates	\$ (154)	\$ (42)
U.K. electric delivery revenue	14	3
	<u>\$ (140)</u>	<u>\$ (39)</u>

Higher U.K. electric delivery revenues for 2009 compared with 2008, excluding foreign currency exchange rate impacts, were primarily due to an increase in prices effective April 1, a revised estimate of network electricity losses, and favorable changes in customer mix. These increases were partially offset by lower volumes due to unfavorable economic conditions, including industrial customers scaling back on production, and a decrease in engineering and metering services performed for third parties.

## Energy-related Businesses

Energy-related businesses contributed \$10 million less to operating income in 2009 compared with 2008. The decrease was primarily attributable to:

- contributions from domestic energy services-related businesses decreasing by \$6 million, primarily due to a decline in construction activity caused by the slowdown in the economy; and
- contributions from U.K. energy-related businesses decreasing by \$4 million, primarily due to changes in foreign currency exchange rates.

Energy-related businesses contributed \$30 million more to operating income in 2008 compared with 2007. The increase was primarily attributable to:

- a \$39 million impairment in 2007 of domestic telecommunication operations that were sold in 2007; and
- an \$11 million increase in contributions from domestic energy services-related businesses mainly due to increased construction activity; partially offset by
- \$11 million of lower pre-tax contributions from synfuel projects. This reflects a \$77 million net gain recorded in 2007 on options purchased to hedge the risk associated with the phase-out of synthetic fuel tax credits. This decrease was partially offset by \$66 million less in operating losses from synfuel projects as the projects ceased operation at the end of 2007; and \$5 million less in contributions from the domestic telecommunication operations sold in 2007.

See Note 8 to the Financial Statements for additional information on the sale of domestic telecommunication assets. See Note 14 to the Financial Statements for additional information on the shutdown of the synfuel facilities in 2007.

## Other Operation and Maintenance

The changes in other operation and maintenance expenses were due to:

	<u>2009 vs. 2008</u>	<u>2008 vs. 2007</u>
U.K. foreign currency exchange rates	\$ (24)	\$ (8)
Impairment of cancelled generation expansion project in 2008 (Note 8)	(22)	22
Defined benefit costs - U.K. (Note 12)	(16)	(28)
WPD recoverable engineering services	(9)	(17)
Impairment and other charges - emission allowances (Notes 14 and 17)	(9)	42
Montana basin seepage litigation (Note 14)	(8)	8
Uncollectible accounts	(8)	4
Trademark royalty fees from a PPL subsidiary (Note 15)	(7)	9
WPD meter operator expenses	(7)	(6)
Payroll-related costs	24	(6)
Allocation of corporate service costs	16	(21)
WPD distribution costs	15	7
Domestic and international workforce reductions (Note 12)	13	(10)
Contractor-related expenses	11	(7)
Defined benefit costs - U.S. (Note 12)	11	(3)
Montana hydroelectric litigation (Note 14)	8	1
Other costs at fossil/hydroelectric stations	7	1
Other nuclear related expenses	7	(10)
• Power gains on sales of emission allowances	4	103
• Impairment of transmission rights (a)		(23)
Other - Domestic	(4)	10
Other - U.K.	(5)	(3)

(a) In 2007, Maine Electric Power Company (MEPCO), ISO New England and other New England transmission owners submitted a filing to the FERC seeking to roll the revenue requirement of the MEPCO transmission facilities into the regional transmission rates in New England and to change certain rules concerning the use of the transmission line for energy and capacity. PPL Energy Supply protested this proposal and recorded an impairment of the transmission rights based on their estimated fair value.

**Depreciation**

The increases in depreciation expense were due to:

	<b>2009 vs. 2008</b>	<b>2008 vs. 2007</b>
Additions to PP&E (a)	\$ 40	\$ 37
U.K. foreign currency exchange rates	(25)	(7)
Extension of useful lives of certain WPD network assets in mid-2007 (Note 1)		(13)
Other	(4)	(2)
	\$ 11	\$ 15

(a) Primarily attributable to the completion of the Susquehanna generation uprate and the Montour scrubber projects in 2008 and the Brunner Island scrubber projects in 2009.

**Taxes, Other Than Income**

The changes in taxes, other than income were due to:

	<b>2009 vs. 2008</b>	<b>2008 vs. 2007</b>
Domestic property tax expense (a)	\$ 10	\$ (7)
U.K. foreign currency exchange rates	(12)	(3)
Other	2	(2)
	\$	\$ (12)

) The change in both periods was primarily due to a \$7 million property tax credit recorded by PPL Montana in 2008.

**Other Income - net**

See Note 16 to the Financial Statements for details of other income.

**Other-Than-Temporary Impairments**

Other-than-temporary impairments decreased by \$18 million in 2009 compared with 2008, primarily due to stronger investment returns caused by improved market conditions within the financial markets.

Other-than-temporary impairments increased by \$33 million in 2008 compared with 2007, primarily due to negative investment returns caused by the downturn in the financial markets in 2008.

**Interest Income from Affiliates**

Interest income from affiliates decreased by \$12 million in 2009 compared with 2008, and decreased by \$15 million in 2008 compared with 2007. The decrease in 2009 was primarily due to the decline in the average balance outstanding and the floating interest rate on the collateral deposit related to the PLR contract. The decrease in 2008 was the result of reduced average balances outstanding on notes receivable from affiliates and the floating interest rate on the collateral deposit related to the PLR contract.

**Interest Expense**

The changes in interest expense, which includes "Interest Expense with Affiliate," were due to:

	<b>2009 vs. 2008</b>	<b>2008 vs. 2007</b>
Inflation adjustment on U.K. Index-linked Senior Unsecured Notes	\$ (29)	\$ 6
U.K. foreign currency exchange rates	(17)	(8)
Long-term debt interest expense	(13)	21
Hedging activities	(3)	(4)
Capitalized interest	12	(1)
Short-term debt interest expense	6	8

Amortization of debt issuance costs	6	5
Other	(3)	(3)
	\$ (41)	\$ 24

### Income Taxes

The changes in income taxes were due to:

	2009 vs. 2008	2008 vs. 2007
Lower pre-tax book income	\$ (300)	\$ (6)
Tax on foreign earnings (a)	(43)	(3)
Synthetic fuel and other tax credits (b)	(17)	72
Tax reserve adjustments (a) (c) (d)	(2)	44
Tax return adjustments (d)	44	(16)
Domestic manufacturing deduction	13	(2)
U.K. Finance Act adjustments (e)	8	46
Other	9	(6)
	\$ (288)	\$ 129

- (a) During 2009, WPD recorded a \$46 million foreign tax benefit (and a full tax reserve reflected in "Tax reserve adjustments") related to losses generated by restructuring.
- (b) The Section 29/45K synthetic fuel tax credits expired at the end of 2007. During 2008, PPL recorded a \$13 million adjustment to its estimated 2007 fuel tax credits as a result of the IRS publishing the final 2007 inflation-adjusted credit in April 2008.
- (c) During 2007, PPL Energy Supply recorded a \$35 million benefit as a result of the expiration of applicable statutes of limitations. The expiration of applicable statutes of limitations resulted in an \$8 million benefit in 2008. Additionally, PPL Energy Supply recorded tax benefits of \$27 million in 2009 for the settlement of a tax dispute and foreign currency exchange losses.
- (d) During 2009, PPL Energy Supply received consent from the IRS to change its method of accounting for certain expenditures for tax purposes. PPL Energy Supply deducted the resulting IRC Sec. 481 adjustment on its 2008 tax return and recorded a \$21 million adjustment to federal and state income tax expense, which results from the reduction of federal income tax benefits, related to the domestic manufacturing deduction and a reduction of certain state tax benefits related to state net operating losses. During 2008, WPD recorded tax benefits of approximately \$17 million from tax return adjustments that were fully reserved.
- (e) The U.K.'s Finance Act of 2008, enacted in July 2008, included a phase-out of tax depreciation on certain buildings. As a result, WPD recorded an \$8 million deferred tax benefit during 2008 related to the reduction in its deferred tax liabilities.

The U.K.'s Finance Act of 2007, enacted in July 2007, included a reduction in the U.K.'s statutory income tax rate. Effective April 1, 2008, the statutory income tax rate was reduced from 30% to 28%. As a result, WPD recorded a \$54 million deferred tax benefit during 2007 related to the reduction in its deferred tax liabilities.

See Note 5 to the Financial Statements for additional information on income taxes.

### Discontinued Operations

See Note 9 to the Financial Statements for information related to:

- the anticipated sale of the Long Island generation business;
- the sale of the majority of the Maine hydroelectric generation business in 2009;
- the sale of the 8.33% interest in Wyman Unit 4 in 2009; and
- the sale of the Latin American businesses in 2007 and the substantial dissolution of the remaining holding companies in 2008.

### Financial Condition

#### Liquidity and Capital Resources

PPL Energy Supply expects to continue to have adequate liquidity available through operating cash flows, cash and cash equivalents and its credit facilities. Additionally, subject to market conditions, PPL Energy Supply currently plans to access debt capital markets in 2010.

PPL Energy Supply's cash flows from operations and access to cost-effective bank and capital markets are subject to risks and uncertainties including, but not limited to:

- changes in market prices for electricity;
- changes in commodity prices that may increase the cost of producing power or decrease the amount PPL Energy Supply receives from selling power;
- operational and credit risks associated with selling and marketing products in the wholesale power markets;
- potential ineffectiveness of the trading, marketing and risk management policy and programs used to mitigate PPL Energy Supply's risk exposure to adverse electricity and fuel prices, interest rates, foreign currency exchange rates and counterparty credit;

- unusual or extreme weather that may damage PPL Energy Supply's international distribution facilities or affect energy sales to customers;
- reliance on transmission and distribution facilities that PPL Energy Supply does not own or control to deliver its electricity and natural gas;
- unavailability of generating units (due to unscheduled or longer-than-anticipated generation outages, weather and natural disasters) and the resulting loss of revenues and additional costs of replacement electricity;
- the ability to recover and the timeliness and adequacy of recovery of costs associated with international electricity delivery businesses;
- costs of compliance with existing and new environmental laws and with new security and safety requirements for nuclear facilities;
- any adverse outcome of legal proceedings and investigations with respect to PPL Energy Supply's current and past business activities;
- deterioration in the financial markets that could make obtaining new sources of bank and capital markets funding more difficult and more costly; and
- a downgrade in PPL Energy Supply's or its rated subsidiaries' credit ratings that could adversely affect their ability to access capital and increase the cost of credit facilities and any new debt.

See "Item 1A. Risk Factors" for further discussion of risks and uncertainties affecting PPL Energy Supply's cash flows.

At December 31, PPL Energy Supply had the following:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Cash and cash equivalents	\$ 245	\$ 464	\$ 355
Short-term investments (a) (b)	<u>150</u>	<u>150</u>	<u>102</u>
	<u>\$ 245</u>	<u>\$ 614</u>	<u>\$ 457</u>
Short-term debt	<u>\$ 639</u>	<u>\$ 584</u>	<u>\$ 51</u>

(a) 2008 amount represents tax-exempt bonds issued by the PEDFA in December 2008 on behalf of PPL Energy Supply and purchased by a subsidiary of PPL Energy Supply upon issuance. Such bonds were refunded in April 2009. See Note 7 to the Financial Statements for further discussion.

(b) Includes \$10 million of auction rate securities at December 31, 2007. See below for a discussion of auction rate securities.

The changes in PPL Energy Supply's cash and cash equivalents position resulted from:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Net Cash Provided by Operating Activities	\$ 1,413	\$ 1,039	\$ 1,094
Net Cash Used in Investing Activities	(551)	(1,696)	(305)
Net Cash Provided by (Used in) Financing Activities	(1,081)	779	(963)
Effect of Exchange Rates on Cash and Cash Equivalents	<u>(13)</u>	<u>(13)</u>	<u>5</u>
Net Increase (Decrease) in Cash and Cash Equivalents	<u>\$ (219)</u>	<u>\$ 109</u>	<u>\$ (169)</u>

#### Auction Rate Securities

PPL Energy Supply held auction rate securities with an aggregate par value of \$20 million and \$24 million at December 31, 2009 and 2008. Historically, an active market existed for such investments, and the auctions provided an opportunity for investors either to hold an investment at a periodically reset interest rate or to sell the investment at its par value for immediate liquidity. In early 2008, investor concerns about credit and liquidity in the financial markets, generally, as well as investor concerns over specific insurers that guarantee the credit of certain of the underlying securities, created uncertainty in the auction rate securities market and these securities generally failed to be remarketed through their established auction process. The auctions continue to fail and the resulting illiquidity continues to impact PPL Energy Supply's investment in auction rate securities.

At December 31, 2008, PPL Energy Supply estimated that the fair value of its auction rate securities was \$19 million, which is reflected in "Other investments" on the Balance Sheet and represented a temporary decline of \$5 million from par value.

In 2009, PPL Energy Supply liquidated \$4 million of auction rate securities at par. At December 31, 2009, PPL Energy Supply estimated that the fair value of its auction rate securities was equal to par value, which was \$20 million and is reflected in "Other investments" on the Balance Sheet. PPL Energy Supply reversed the previously recorded temporary impairment.

Because PPL Energy Supply intends and has the ability to hold these auction rate securities until they can be liquidated at par value, PPL Energy Supply believes that it does not have significant exposure to realize losses on these securities. Based upon the evaluation of available information, PPL Energy Supply believes these investments continue to be of high credit quality. Additionally, PPL Energy Supply does not anticipate having to sell these securities to fund operations. See Notes 17 and 21 to the Financial Statements for further discussion of auction rate securities.

#### Operating Activities

Net cash provided by operating activities increased by 36%, or \$374 million, in 2009 compared with 2008, primarily as a result of the return of \$300 million in cash collateral from PPL Electric related to the long-term PLR energy supply agreements (which expired at the end of 2009); cash collateral received from counterparties; and the benefit of lower income tax payments due to the change in method of accounting for

certain expenditures for tax purposes. These increases were partially offset by a decrease in accounts payable and the unfavorable impact of foreign currency exchange rates in 2009 compared with 2008.

Net cash provided by operating activities decreased by 5%, or \$55 million, in 2008 compared with 2007, primarily as a result of increased expenditures for fuel, primarily due to higher coal prices, lower realized net energy trading margins, driven by significant decreases in power and gas prices, higher interest paid, primarily due to higher debt levels in 2008, and cash flows provided by Latin America's operations in 2007 but not 2008, due to the sale of the Latin American businesses in 2007. The decreases to cash provided by operating activities resulting from these items were partially offset by higher revenues, due primarily to the hedged sale of generation in the wholesale market, increased sales volumes to PPL Electric under the PLR contracts to support the PLR load and a 1.4% increase in PLR sales prices, as well as less U.S. income tax payments, primarily as a result of a refund received in 2008, and operating losses incurred in 2007 in connection with synfuel projects that ceased operation at the end of 2007.

A significant portion of PPL Energy Supply's operating cash flows is derived from its Supply segment baseload generation business activities. PPL Energy Supply employs a formal hedging program for its baseload generation fleet, the primary objective of which is to provide a reasonable level of near-term cash flow and earnings certainty over the next three years, while preserving upside potential if power prices increase over the medium term. See Note 18 to the Financial Statements for further discussion. Based on its generation portfolio contracting practices (including related fuel purchases and commitments), PPL Energy Supply expects to achieve relatively stable cash flows related to baseload generation during the next three years, although, future cash flows from operating activities are expected to be influenced more by commodity prices than during the past nine years when long-term supply contracts were in place between PPL EnergyPlus and PPL Electric. As discussed in "Item 1. Business," PPL Energy Supply estimates that, on average, approximately 94% of its total expected annual generation output (which includes baseload and other generation) for 2010 is committed under power sales contracts. PPL Energy Supply has also entered into commitments of varying quantities and terms for the years 2011 and beyond.

PPL Energy Supply's contracts for the sale and purchase of electricity and fuel often require cash collateral or other credit enhancements, or reductions or terminations of a portion of the entire contract through cash settlement, in the event of a downgrade of PPL Energy Supply's or its subsidiary's credit ratings or adverse changes in market prices. For example, in addition to limiting its trading ability, if PPL Energy Supply's or its subsidiary's ratings were lowered to below "investment grade" and there was a 10% adverse movement in energy prices, PPL Energy Supply estimates that, based on its December 31, 2009 positions, it would have had to post additional collateral of approximately \$291 million, compared with \$815 million at December 31, 2008. PPL Energy Supply has in place risk management programs that are designed to monitor and manage its exposure to volatility of cash flows related to changes in energy and fuel prices, interest rates, foreign currency exchange rates, counterparty credit quality and the operating performance of its generating units.

#### Investing Activities

The primary use of cash in investing activities is capital expenditures. See "Forecasted Uses of Cash" for detail regarding capital expenditures in 2009 and projected expenditures for the years 2010 through 2012.

Net cash used in investing activities decreased 68%, or \$1.1 billion in 2009 compared with 2008, primarily as a result of a change of \$371 million from restricted cash and cash equivalents, a change of \$249 million from purchases and sales of other investments, a change of \$244 million from purchases and sales of intangible assets, a decrease of \$207 million in capital expenditures and \$81 million of proceeds received in 2009 from the sale of the majority of the Maine hydroelectric generation business. See Note 1 to the Financial Statements for a discussion of restricted cash and cash equivalents and Note 7 to the Financial Statements for a discussion of the purchase and sale by a subsidiary of PPL Energy Supply of Exempt Facilities Revenue Bonds issued by the PEDFA on behalf of PPL Energy Supply and Note 9 to the Financial Statements for a discussion of the sale of the majority of the Maine hydroelectric generation business.

Net cash used in investing activities increased 456%, or \$1.4 billion, in 2008 compared with 2007, as PPL Energy Supply received aggregate proceeds of \$898 million from the sale of its Latin American businesses and telecommunication operations in 2007, which are discussed in Notes 8 and 9 to the Financial Statements. Additionally, there was a change of \$329 million from purchases and sales of other investments, a change of \$352 million from purchases and sales of intangible assets, and an increase of \$42 million in the amount of cash and cash equivalents that became restricted. The increase in cash used in investing activities from the above items was partially offset by a decrease of \$217 million in capital expenditures.

#### Financing Activities

Net cash used in financing activities was \$1.1 billion in 2009 compared with \$779 million of net cash provided by financing activities in 2008 and net cash used in financing activities of \$963 million in 2007. The change from 2008 to 2009 primarily reflects no issuances of long-term debt in 2009, reduced contributions from Member, increased distributions to Member and less short-term borrowings in 2009. The change from 2007 to 2008 primarily reflects increased issuances and lower retirements of long-term debt, reduced distributions to and contributions from Member and increased short-term borrowings in 2008.

In 2009, cash used in financing activities primarily consisted of \$943 million in distributions to Member and net debt retirements of \$177 million, partially offset by \$50 million in contributions from Member. In 2008, cash provided by financing activities primarily consisted of net debt issuances of \$1.1 billion and \$421 million in contributions from Member, partially offset by \$750 million in distributions to Member. In 2007, cash used in financing activities primarily consisted of net debt retirements of \$180 million and \$1.5 billion of distributions to Member, partially offset by \$700 million in contributions from Member.

See "Forecasted Sources of Cash" for a discussion of PPL Energy Supply's plans to issue debt securities, as well as a discussion of credit facility capacity available to PPL Energy Supply. Also see "Forecasted Uses of Cash" for information regarding maturities of PPL Energy

Supply's long-term debt.

PPL Energy Supply's debt financing activity in 2009 was:

	<u>Issuances</u>	<u>Retirements</u>
PPL Energy Supply Senior Unsecured Notes (a)		\$ (220)
WPD short-term debt (net change)	\$ 43	
Total	<u>\$ 43</u>	<u>\$ (220)</u>
Net decrease		<u>\$ (177)</u>

(a) In March 2009, PPL Energy Supply paid \$220 million, plus accrued interest, to complete tender offers to purchase up to \$250 million aggregate principal amount of certain of its outstanding senior notes in order to reduce future interest expense. Under the Economic Stimulus Package, PPL will be permitted to defer recognition of income related to the extinguishment of these notes for tax purposes. No amounts will be included in taxable income for the first five years. Beginning in 2014, income related to the extinguishment of these notes will be included in taxable income ratably over five years.

See Note 7 to the Financial Statements for more detailed information regarding PPL Energy Supply's financing activities in 2009.

#### Forecasted Sources of Cash

PPL Energy Supply expects to continue to have significant sources of cash available in the near term, including various credit facilities, operating leases and contributions from Member. Additionally, PPL Energy Supply expects to have access to debt capital markets and currently plans to issue up to \$300 million and £400 million in long-term debt securities in 2010, subject to market conditions.

#### *Credit Facilities*

At December 31, 2009, PPL Energy Supply's total committed borrowing capacity under credit facilities and the use of this borrowing capacity were:

	<u>Committed Capacity</u>	<u>Borrowed</u>	<u>Letters of Credit Issued (a)</u>	<u>Unused Capacity</u>
PPL Energy Supply Domestic Credit Facilities (b)	\$ 4,125	\$ 285	\$ 662	\$ 3,178
WPDH Limited Credit Facility (c)	£ 150	£ 132	n/a	£ 18
WPD (South West) Credit Facilities (d)	214	60	3	151
Total WPD Credit Facilities (e)	<u>£ 364</u>	<u>£ 192</u>	<u>£ 3</u>	<u>£ 169</u>

(a) The borrower under each of these facilities has a reimbursement obligation to the extent any letters of credit are drawn upon.

(b) PPL Energy Supply has the ability to borrow \$3.6 billion under its credit facilities. Such borrowings generally bear interest at LIBOR-based rates plus a spread, depending upon the company's public debt rating. PPL Energy Supply also has the capability to cause the lenders to issue up to \$3.9 billion of letters of credit under these facilities, which issuances reduce available borrowing capacity. Under certain conditions, PPL Energy Supply may request that the capacity of one of its facilities be increased by up to \$500 million.

These credit facilities contain a financial covenant requiring debt to total capitalization to not exceed 65%. At December 31, 2009 and 2008, PPL Energy Supply's consolidated debt to total capitalization percentages, as calculated in accordance with its credit facilities, were 46% and 44%. The credit facilities also contain standard representations and warranties that must be made for PPL Energy Supply to borrow under them.

The commitments under PPL Energy Supply's domestic credit facilities are provided by a diverse bank group, with no one bank and its affiliates providing an aggregate commitment of more than 16% of the total committed capacity.

The committed capacity expires as follows: \$600 million in 2010, \$300 million in 2011 and \$3.2 billion in 2012. PPL Energy Supply intends to renew or replace the two credit facilities that expire in 2010 in order to maintain its current total committed capacity level.

(c) Borrowings under WPDH Limited's credit facility bear interest at LIBOR-based rates plus a spread, depending upon the company's public debt rating.

This credit facility contains financial covenants that require WPDH Limited to maintain an interest coverage ratio of not less than 3.0 times consolidated earnings before income taxes, depreciation and amortization and a RAB that exceeds total net debt by the higher of an amount equal to 15% of total net debt or £150 million, in each case as calculated in accordance with the credit facility. At December 31, 2009 and 2008, WPDH Limited's interest coverage ratios, as calculated in accordance with its credit facility, were 4.3 and 4.6. At December 31, 2009 and 2008, WPDH Limited's RAB, as calculated in accordance with the credit facility, exceeded its total net debt by £325 million, or

25%, and £385 million, or 31%.

- (d) WPD (South West) has two credit facilities: one under which it can make cash borrowings and another under which it has the capability to cause the lender to issue up to approximately £4 million of letters of credit. Borrowings bear interest at LIBOR-based rates plus a margin.

The credit facility under which it can make cash borrowings contains financial covenants that require WPD (South West) to maintain an interest coverage ratio of not less than 3.0 times consolidated earnings before income taxes, depreciation and amortization and total net debt not in excess of 85% of RAB, in each case as calculated in accordance with the credit facility. At December 31, 2009, WPD (South West)'s interest coverage ratio, as calculated in accordance with its credit facility, was 5.3. At December 31, 2009, WPD (South West)'s total net debt, as calculated in accordance with the credit facility, was 67% of RAB.

- (e) The commitments under WPD's credit facilities are provided by eight banks, with no one bank providing more than 25% of the total committed capacity.

The committed capacity of WPD's credit facilities expires as follows: £4 million in 2010, £210 million in 2012 and £150 million in 2013. WPD (South West) intends to renew its letter of credit facility that expires in 2010 in order for WPD to maintain its current total committed capacity level.

At December 31, 2009, the unused capacity of WPD's credit facilities was approximately \$276 million.

In addition to the financial covenants noted in the table above, the credit agreements governing the credit facilities contain various other covenants. Failure to comply with the covenants after applicable grace periods could result in acceleration of repayment of borrowings and/or termination of the agreements. PPL Energy Supply monitors compliance with the covenants on a regular basis. At December 31, 2009, PPL Energy Supply was in material compliance with these covenants. At this time, PPL Energy Supply believes that these covenants and other borrowing conditions will not limit access to these funding sources.

See Note 7 to the Financial Statements for further discussion of PPL Energy Supply's credit facilities.

#### *Commercial Paper*

As discussed below under "Credit Ratings," S&P lowered its rating on PPL Energy Supply's commercial paper to A-3 from A-2 in January 2009. Since PPL Energy Supply did not plan to issue any commercial paper during 2009 and there was essentially no liquidity in commercial paper markets for paper with an A-3 rating, PPL Energy Supply closed its \$500 million commercial paper program in January 2009 and requested that Moody's, S&P and Fitch each withdraw their ratings on its commercial paper program, which each rating agency subsequently did.

PPL Energy Supply may reopen its commercial paper program in the future, depending on market conditions and credit ratings, to provide an additional financing source to fund its short-term liquidity needs, if and when necessary. Any future commercial paper issuances would be supported by PPL Energy Supply's credit facilities.

#### *Operating Leases*

PPL Energy Supply and its subsidiaries also have available funding sources that are provided through operating leases. PPL Energy Supply's subsidiaries lease office space, land, buildings and certain equipment. These leasing structures provide PPL Energy Supply additional operating and financing flexibility. The operating leases contain covenants that are typical for these agreements, such as maintaining insurance, maintaining corporate existence and timely payment of rent and other fees.

PPL Energy Supply, through its subsidiary PPL Montana, leases a 50% interest in Colstrip Units 1 and 2 and a 30% interest in Unit 3, under four 36-year, non-cancelable operating leases. These operating leases are not recorded on PPL Energy Supply's Balance Sheets. The leases place certain restrictions on PPL Montana's ability to incur additional debt, sell assets and declare dividends. At this time, PPL Energy Supply believes that these restrictions will not limit access to these funding sources or cause acceleration or termination of the leases. See Note 7 to the Financial Statements for a discussion of other dividend restrictions related to WPD.

See Note 10 to the Financial Statements for further discussion of the operating leases.

#### *Long-Term Debt Securities and Contributions from Member*

Subject to market conditions, PPL Energy Supply currently plans to issue up to \$300 million and £400 million in long-term debt securities in 2010. PPL expects to use the proceeds from these issuances for the repayment of short-term debt, to fund capital expenditures, and for general corporate purposes.

From time to time, as determined by its Board of Directors, PPL Energy Supply's Member, PPL Energy Funding, makes capital contributions to PPL Energy Supply. PPL Energy Supply uses these contributions for general corporate purposes.

#### Forecasted Uses of Cash

In addition to expenditures required for normal operating activities, such as purchased power, payroll, fuel and taxes, PPL Energy Supply currently expects to incur future cash outflows for capital expenditures, various contractual obligations, distributions to its Member and



possibly the purchase or redemption of a portion of its debt securities.

### Capital Expenditures

The table below shows PPL Energy Supply's actual spending for the year 2009 and current capital expenditure projections for the years 2010 through 2012.

	<u>Actual</u>	<u>Projected</u>		
	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
Construction expenditures (a) (b)				
Generating facilities	\$ 361	\$ 671	\$ 673	\$ 507
Transmission and distribution facilities	247	320	358	385
Environmental	178	63	19	99
Other	11	31	33	31
Total Construction Expenditures	<u>797</u>	<u>1,085</u>	<u>1,083</u>	<u>1,022</u>
Nuclear fuel	140	151	173	171
Total Capital Expenditures	<u>\$ 937</u>	<u>\$ 1,236</u>	<u>\$ 1,256</u>	<u>\$ 1,193</u>

- (a) Construction expenditures include capitalized interest, which is expected to be approximately \$156 million for the years 2010 through 2012.
- (b) Includes expenditures for certain intangible assets.

PPL Energy Supply's capital expenditure projections for the years 2010 through 2012 total approximately \$3.7 billion. Capital expenditure plans are revised periodically to reflect changes in operational, market and regulatory conditions. This table includes projected costs related to the planned 239 MW of incremental capacity increases. See Note 8 to the Financial Statements for information regarding the significant development projects.

PPL Energy Supply plans to fund its capital expenditures in 2010 with cash on hand, cash from operations, contributions from Member and proceeds from the issuance of debt securities.

### Contractual Obligations

PPL Energy Supply has assumed various financial obligations and commitments in the ordinary course of conducting its business. At December 31, 2009, the estimated contractual cash obligations of PPL Energy Supply were:

	<u>Total</u>	<u>Less Than 1 Year</u>	<u>1-3 Years</u>	<u>4-5 Years</u>	<u>After 5 Years</u>
Long-term Debt (a)	\$ 4,992		\$ 500	\$ 1,037	\$ 3,455
Interest on Long-term Debt (b)	4,497	\$ 291	558	477	3,171
Operating Leases	968	108	216	223	421
Purchase Obligations (c)	5,896	1,459	1,680	867	1,890
Other Long-term Liabilities Reflected on the Balance Sheet under GAAP (d) (e)	80	62	18		
Total Contractual Cash Obligations	<u>\$ 16,433</u>	<u>\$ 1,920</u>	<u>\$ 2,972</u>	<u>\$ 2,604</u>	<u>\$ 8,937</u>

- (a) Reflects principal maturities only based on legal maturity dates. See Note 7 to the Financial Statements for a discussion of the remarketing feature related to PPL Energy Supply's 5.70% REset Put Securities, as well as discussion of variable-rate remarketable bonds issued by the PEDFA on behalf of PPL Energy Supply. PPL Energy Supply does not have any significant capital lease obligations.
- (b) Assumes interest payments through maturity. The payments herein are subject to change, as payments for debt that is or becomes variable-rate debt have been estimated and payments denominated in British pounds sterling have been translated to U.S. dollars at a current foreign currency exchange rate.
- (c) The payments reflected herein are subject to change, as certain purchase obligations included are estimates based on projected obligated quantities and/or projected pricing under the contracts. Purchase orders made in the ordinary course of business are excluded from the amounts presented. The payments also include obligations related to nuclear fuel and the installation of the scrubbers, which are also reflected in the Capital Expenditures table presented above.
- (d) The amounts reflected represent WPD's contractual deficit pension funding requirements arising from an actuarial valuation performed in March 2007. The U.K. electricity regulator currently allows a recovery of a substantial portion of the contributions relating to the plan deficit; however, WPD cannot be certain that this will continue beyond the current and next review periods, which extend to March 31, 2015. Based on the current funded status of PPL Energy Supply's U.S. qualified pension plans, no cash contributions are required. See Note 12 to the Financial Statements for a discussion of expected contributions.
- (e) At December 31, 2009, total unrecognized tax benefits of \$124 million were excluded from this table as PPL Energy Supply cannot reasonably estimate the amount and period of future payments. See Note 5 to the Financial Statements for additional information.

### Distributions to Member

From time to time, as determined by its Board of Managers, PPL Energy Supply makes return of capital distributions to its Member.

#### *Purchase or Redemption of Debt Securities*

PPL Energy Supply will continue to evaluate purchasing or redeeming outstanding debt securities and may decide to take action depending upon prevailing market conditions and available cash.

#### Credit Ratings

Moody's, S&P and Fitch periodically review the credit ratings on the debt securities of PPL Energy Supply and its subsidiaries. Based on their respective independent reviews, the rating agencies may make certain ratings revisions or ratings affirmations.

A credit rating reflects an assessment by the rating agency of the creditworthiness associated with an issuer and particular securities that it issues. The credit ratings of PPL Energy Supply and its subsidiaries are based on information provided by PPL Energy Supply and other sources. The ratings of Moody's, S&P and Fitch are not a recommendation to buy, sell or hold any securities of PPL Energy Supply or its subsidiaries. Such ratings may be subject to revisions or withdrawal by the agencies at any time and should be evaluated independently of each other and any other rating that may be assigned to the securities. A downgrade in PPL Energy Supply's or its subsidiaries' credit ratings could result in higher borrowing costs and reduced access to capital markets.

The following table summarizes the credit ratings of PPL Energy Supply and its rated subsidiaries at December 31, 2009:

	<u>Moody's</u>	<u>S&amp;P</u>	<u>Fitch (a)</u>
<b>PPL Energy Supply (b)</b>			
Issuer Rating		BBB	BBB
Senior Unsecured Notes	Baa2	BBB	BBB
Outlook	STABLE	Negative	STABLE
<b>PPL Montana</b>			
Pass-Through Certificates	Baa3	BBB-	BBB
Outlook	STABLE	STABLE	
<b>WPDH Limited</b>			
Issuer Rating	Baa3	BBB-	BBB-
Senior Unsecured Debt	Baa3	BBB-	BBB
Short-term Debt		A-3	
Outlook	STABLE	Negative	POSITIVE
<b>WPD LLP</b>			
Issuer Rating			BBB
Outlook			POSITIVE
<b>WPD (South Wales)</b>			
Issuer Rating		BBB+	BBB+
Senior Unsecured Debt	Baa1	BBB+	A-
Short-term Debt		A-2	F2
Outlook	STABLE	Negative	POSITIVE
<b>WPD (South West)</b>			
Issuer Rating	Baa1	BBB+	BBB+
Senior Unsecured Debt	Baa1	BBB+	A-
Short-term Debt	P-2	A-2	F2
Outlook	STABLE	Negative	POSITIVE

(a) All Issuer Ratings for Fitch are "Issuer Default Ratings."

(b) Excludes Exempt Facilities Revenue Bonds issued by the PEDFA on behalf of PPL Energy Supply, which are each currently supported by a letter of credit and are rated on the basis of the credit enhancement.

In January 2009, S&P completed a review of PPL Energy Supply, upon which it revised its outlook to negative from stable and affirmed its BBB issuer rating. As a result of the negative outlook, S&P lowered PPL Energy Supply's commercial paper rating to A-3 from A-2. S&P stated in its press release that the revision in the outlook for PPL Energy Supply was based primarily on lower than expected cash flows for 2008 combined with concerns over further pressure on financial metrics in 2009.

At the request of PPL Energy Supply, in the first quarter of 2009, Moody's, S&P and Fitch, each withdrew their commercial paper rating for PPL Energy Supply.

In February 2009, S&P revised its outlook to negative from stable for each of WPDH Limited, WPD LLP, WPD (South Wales) and WPD (South West) and affirmed the issuer and short-term debt ratings of each of the entities. S&P stated in its press release that the revision in the outlook is a reflection of the change to PPL's outlook to negative from stable and is not a result of any change in WPD's stand-alone credit

profile.

In May 2009, Moody's completed a review of PPL Energy Supply and affirmed the Baa2 senior unsecured rating and stable outlook of PPL Energy Supply.

At WPD's request, in September 2009, S&P withdrew its ratings for WPD LLP, since it did not have any securities outstanding.

In October 2009, Fitch completed a review of PPL Energy Supply. As a result of that review, Fitch lowered the rating of PPL Energy Supply's senior unsecured notes to BBB from BBB+ and affirmed all other ratings of PPL Energy Supply. Fitch stated in its press release that the change in the rating of PPL Energy Supply's senior unsecured notes aligns such rating with the BBB Issuer Default Rating in a manner that is consistent with the approach Fitch applies to other competitive generators and also recognizes a lower valuation of PPL Energy Supply's power assets based on current and forward wholesale power prices. The rating also reflects Fitch's forecast of lower than previously expected improvement in PPL Energy Supply's earnings and cash flow in 2010 and 2011.

#### Ratings Triggers

WPD (South West)'s 1.541% Index-linked Notes due 2053 and 2056 and WPD (South Wales)'s 4.80436% Notes due 2037 may be put by the holders back to the issuer for redemption if the long-term credit ratings assigned to the notes by Moody's, S&P or Fitch are withdrawn by any of the rating agencies or reduced to a non-investment grade rating of Ba1 or BB+ in connection with a restructuring event. A restructuring event includes the loss of, or a material adverse change to, the distribution license under which WPD (South West) and WPD (South Wales) operate. These notes totaled £467 million (approximately \$766 million) at December 31, 2009.

PPL Energy Supply has various derivative and non-derivative contracts, including contracts for the sale and purchase of electricity and fuel, commodity transportation and storage, tolling agreements, and interest rate and foreign currency instruments, which contain provisions requiring PPL Energy Supply to post additional collateral, or permit the counterparty to terminate the contract, if PPL Energy Supply's credit rating were to fall below investment grade. See Note 18 to the Financial Statements for a discussion of "Credit Risk-Related Contingent Features," including a discussion of the potential additional collateral that would have been required for derivative contracts in a net liability position at December 31, 2009. At December 31, 2009, if PPL Energy Supply's credit rating had been below investment grade, PPL Energy Supply would have been required to post an additional \$298 million of collateral to counterparties for both derivative and non-derivative commodity and commodity-related contracts used in its generation, marketing and trading operations and interest rate and foreign currency contracts.

#### Guarantees for Subsidiaries

At times, PPL Energy Supply provides guarantees for financing arrangements to enable certain transactions for its consolidated affiliates. Some of the guarantees contain financial and other covenants that, if not met, would limit or restrict the consolidated affiliates' access to funds under these financing arrangements, require early maturity of such arrangements or limit the consolidated affiliates' ability to enter into certain transactions. At this time, PPL Energy Supply believes that these covenants will not limit access to relevant funding sources. See Note 14 to the Financial Statements for additional information about guarantees.

#### **Off-Balance Sheet Arrangements**

PPL Energy Supply has entered into certain agreements that may contingently require payment to a guaranteed or indemnified party. See Note 14 to the Financial Statements for a discussion of these agreements.

#### **Risk Management - Energy Marketing & Trading and Other**

##### Market Risk

See Notes 1, 17, and 18 to the Financial Statements for information about PPL Energy Supply's risk management objectives, valuation techniques and accounting designations.

The forward-looking information presented below provides estimates of what may occur in the future, assuming certain adverse market conditions and model assumptions. Actual future results may differ materially from those presented. These disclosures are not precise indicators of expected future losses, but only indicators of possible losses under normal market conditions at a given confidence level.

##### *Commodity Price Risk (Non-trading)*

PPL Energy Supply segregates its non-trading activities into two categories: hedge activity and economic activity. Transactions that are accounted for as hedge activity qualify for hedge accounting treatment. The economic activity category includes transactions that address a specific risk, but were not eligible for hedge accounting or for which hedge accounting was not elected. This activity includes the changes in fair value of positions used to hedge a portion of the economic value of PPL Energy Supply's generation assets, load-following and retail activities. This economic activity is subject to changes in fair value due to market price volatility of the input and output commodities (e.g., oil and power). Although they do not receive hedge accounting treatment, these transactions are considered non-trading activity. The net fair value of economic positions at December 31, 2009 and 2008 was a net liability of \$77 million and \$52 million. See Note 18 for additional information on economic activity.

To hedge the impact of market price volatility on PPL Energy Supply's energy-related assets, liabilities and other contractual arrangements,

PPL EnergyPlus sells and purchases physical energy at the wholesale level under FERC market-based tariffs throughout the U.S. and enters into financial exchange-traded and over-the-counter contracts. PPL Energy Supply's non-trading commodity derivative contracts mature at various times through 2017.

Within PPL's non-trading portfolio, the decision to enter into energy contracts is influenced by the expected value of PPL Energy Supply's generation. In determining the number of MWhs that are available to be sold forward, PPL Energy Supply first reduces the potential output by the amount of unavailable generation due to planned maintenance on a particular unit. The potential output is further reduced by the amount of MWhs that historically is not produced by a plant due to such factors as equipment breakage. Finally, the potential output of certain plants (such as peaking units) is reduced if their higher cost of production will not allow them to economically run during all hours.

PPL Energy Supply's non-trading portfolio also includes full requirements energy contracts. The net obligation to serve these contracts changes minute-by-minute. Anticipated usage patterns and energy peaks are affected by expected load changes, regional economic drivers, customer shopping or migration and seasonal weather patterns. PPL Energy Supply analyzes historical on-peak and off-peak usage patterns, expected load changes, regional economic drivers, and weather patterns, among other factors, to determine monthly levels of electricity that best fits usage patterns to minimize earnings exposure. To satisfy its full requirements obligations, PPL Energy Supply generally enters into contracts to purchase unbundled products of electricity, capacity, RECs and other ancillary products. To a lesser extent, PPL Energy Supply reserves a portion of its generation for full requirements contracts that is expected to be the best match with anticipated usage patterns and energy peaks.

The following chart sets forth the net fair value of PPL Energy Supply's non-trading commodity derivative contracts. See Notes 17 and 18 to the Financial Statements for additional information.

	<b>Gains (Losses)</b>	
	<b>2009</b>	<b>2008</b>
Fair value of contracts outstanding at the beginning of the period	\$ 402	\$ (305)
Contracts realized or otherwise settled during the period	189	(49)
Fair value of new contracts entered into during the period	143	101
Changes in fair value attributable to changes in valuation techniques (a)		158
Other changes in fair value	546	497
Fair value of contracts outstanding at the end of the period	<u>\$ 1,280</u>	<u>\$ 402</u>

(a) Amount represents the reduction of valuation reserves related to capacity and FTR contracts upon the adoption of fair value accounting guidance.

The following table segregates the net fair value of PPL Energy Supply's non-trading commodity derivative contracts at December 31, 2009 based on whether the fair value was determined by prices quoted in active markets for identical instruments or other more subjective means.

	<b>Net Asset (Liability)</b>				<b>Total Fair Value</b>
	<b>Maturity Less Than 1 Year</b>	<b>Maturity 1-3 Years</b>	<b>Maturity 4-5 Years</b>	<b>Maturity in Excess of 5 Years</b>	
<b>Source of Fair Value</b>					
Prices quoted in active markets for identical instruments					
Prices based on significant other observable inputs	\$ 363	\$ 736	\$ 73		\$ 1,172
Prices based on significant unobservable inputs	(1)	13	30	\$ 66	108
Fair value of contracts outstanding at the end of the period	<u>\$ 362</u>	<u>\$ 749</u>	<u>\$ 103</u>	<u>\$ 66</u>	<u>\$ 1,280</u>

PPL Energy Supply sells electricity, capacity and related services and buys fuel on a forward basis to hedge the value of energy from its generation assets. If PPL Energy Supply were unable to deliver firm capacity and energy or to accept the delivery of fuel under its agreements, under certain circumstances it could be required to pay liquidating damages. These damages would be based on the difference between the market price and the contract price of the commodity. Depending on price changes in the wholesale energy markets, such damages could be significant. Extreme weather conditions, unplanned power plant outages, transmission disruptions, nonperformance by counterparties (or their own counterparties) with which it has energy contracts and other factors could affect PPL Energy Supply's ability to meet its obligations, or cause significant increases in the market price of replacement energy. Although PPL Energy Supply attempts to mitigate these risks, there can be no assurance that it will be able to fully meet its firm obligations, that it will not be required to pay damages for failure to perform, or that it will not experience counterparty nonperformance in the future.

#### *Commodity Price Risk (Trading)*

PPL Energy Supply's trading contracts mature at various times through 2015. The following table sets forth changes in the net fair value of PPL Energy Supply's trading commodity derivative contracts. See Notes 17 and 18 to the Financial Statements for additional information.

	Gains (Losses)	
	2009	2008
Fair value of contracts outstanding at the beginning of the period	\$ (75)	\$ 16
Contracts realized or otherwise settled during the period	2	(18)
Fair value of new contracts entered into during the period	31	28
Changes in fair value attributable to changes in valuation techniques (a)		11
Other changes in fair value	36	(112)
Fair value of contracts outstanding at the end of the period	<u>\$ (6)</u>	<u>\$ (75)</u>

(a) In the fourth quarter of 2008, PPL Energy Supply refined its valuation approach for FTR and PJM basis positions, consistent with PPL Energy Supply's practice of pricing other less active trading points, resulting in changes in valuation techniques.

PPL Energy Supply will reverse unrealized gains of approximately \$1 million over the next three months as the transactions are realized.

The following table segregates the net fair value of PPL Energy Supply's trading commodity derivative contracts at December 31, 2009 based on whether the fair value was determined by prices quoted in active markets for identical instruments or other more subjective means.

Source of Fair Value	Net Asset (Liability)				Total Fair Value
	Maturity Less Than 1 Year	Maturity 1-3 Years	Maturity 4-5 Years	Maturity in Excess of 5 Years	
Prices quoted in active markets for identical instruments	\$ 1				\$ 1
Prices based on significant other observable inputs	(4)	\$ (5)	\$ 2	\$ 1	(6)
Prices based on significant unobservable inputs	(1)				(1)
Fair value of contracts outstanding at the end of the period	<u>\$ (4)</u>	<u>\$ (5)</u>	<u>\$ 2</u>	<u>\$ 1</u>	<u>\$ (6)</u>

#### VaR Models

PPL Energy Supply utilizes a VaR model to measure commodity price risk in domestic gross energy margins for its non-trading and trading portfolios. VaR is a statistical model that attempts to estimate the value of potential loss over a given holding period under normal market conditions at a given confidence level. PPL Energy Supply calculates VaR using a Monte Carlo simulation technique based on a five-day holding period at a 95% confidence level. Given the company's conservative hedging program, PPL's non-trading VaR exposure is expected to be limited in the short term. At December 31, 2009 and December 31, 2008, the VaR for PPL Energy Supply's portfolios using end-of-quarter results for the period was as follows.

	Trading VaR		Non-Trading VaR	
	2009	2008	2009	2008
95% Confidence Level, Five-Day Holding Period				
Period End	\$ 3	\$ 3	\$ 8	\$ 10
Average for the Period	4	10	9	14
High	8	22	11	20
Low	1	3	8	9

The trading portfolio includes all speculative positions, regardless of the delivery period. All positions not considered speculative are considered non-trading. PPL Energy Supply's non-trading portfolio includes PPL Energy Supply's entire portfolio, including generation, with delivery periods through the next 12 months. Both the trading and non-trading VaR computations exclude FTRs due to the absence of reliable spot and forward markets. The fair value of the FTR positions at December 31, 2009 was an unrealized loss of \$3 million and consisted of the following.

	2010	2011
Trading (a)		
Non-trading	\$ (2)	\$ (1)
Total	<u>\$ (2)</u>	<u>\$ (1)</u>

(a) The amount of trading FTR positions was less than \$1 million at December 31, 2009.

#### Interest Rate Risk

PPL Energy Supply and its subsidiaries have issued debt to finance their operations, which exposes them to interest rate risk. Both PPL and PPL Energy Supply manage the interest rate risk of PPL Energy Supply by using various financial derivative instruments to adjust the mix of fixed and floating interest rates in its debt portfolio, adjust the duration of its debt portfolio and lock in benchmark interest rates in anticipation of future financing, when appropriate. Risk limits under the risk management program are designed to balance risk exposure to volatility in interest expense and changes in the fair value of PPL Energy Supply's debt portfolio due to changes in the absolute level of interest rates.

At December 31, 2009, PPL Energy Supply's potential annual exposure to increased interest expense, based on a 10% increase in interest rates, was not significant, compared with \$2 million at December 31, 2008.

PPL Energy Supply is also exposed to changes in the fair value of its domestic and international debt portfolios. PPL Energy Supply estimated that a 10% decrease in interest rates at December 31, 2009 would increase the fair value of its debt portfolio by \$187 million, compared with \$234 million at December 31, 2008.

At December 31, PPL Energy Supply had the following interest rate hedges outstanding.

	2009			2008		
	Exposure Hedged	Fair Value, Net - Asset (Liability) (a)	Effect of a 10% Adverse Movement in Rates (b)	Exposure Hedged	Fair Value, Net - Asset (Liability) (a)	Effect of a 10% Adverse Movement in Rates (b)
Cash flow hedges						
Interest rate swaps (c)						
Cross-currency swaps (d)	\$ 302	\$ 8	\$ (41)	\$ 302	\$ 54	\$ (8)
Fair value hedges						
Interest rate swaps (e)				50	3	

(a) Includes accrued interest, if applicable.

(b) Effects of adverse movements decrease assets or increase liabilities, as applicable, which could result in an asset becoming a liability.

(c) PPL and PPL Energy Supply utilize various risk management instruments to reduce PPL Energy Supply's exposure to the expected future cash flow variability of PPL Energy Supply's debt instruments. These risks include exposure to adverse interest rate movements for outstanding variable rate debt and for future anticipated financing. While PPL Energy Supply is exposed to changes in the fair value of these instruments, any changes in the fair value of these instruments are recorded in equity and then reclassified into earnings in the same period during which the item being hedged affects earnings.

(d) WPDH Limited uses cross-currency swaps to hedge the interest payments and principal of its U.S. dollar-denominated senior notes with maturity dates ranging from December 2017 to December 2028. While PPL Energy Supply is exposed to changes in the fair value of these instruments, any change in the fair value of these instruments is recorded in equity and reclassified into earnings in the same period during which the item being hedged affects earnings. Sensitivities represent a 10% adverse movement in both interest rates and foreign currency exchange rates.

(e) PPL and PPL Energy Supply utilize various risk management instruments to adjust the mix of fixed and floating interest rates in PPL Energy Supply's debt portfolio. The change in fair value of these instruments, as well as the offsetting change in the value of the hedged exposure of the debt, is reflected in earnings. Sensitivity represents a 10% adverse movement in interest rates.

#### Foreign Currency Risk

PPL Energy Supply is exposed to foreign currency risk, primarily through investments in U.K. affiliates. In addition, PPL Energy Supply's domestic operations may make purchases of equipment in currencies other than U.S. dollars. See Note 1 to the Financial Statements for additional information regarding foreign currency translation.

PPL and PPL Energy Supply have adopted a foreign currency risk management program designed to hedge certain foreign currency exposures, including firm commitments, recognized assets or liabilities, anticipated transactions and net investments. In addition, PPL and PPL Energy Supply enter into financial instruments to protect against foreign currency translation risk of expected earnings.

At December 31, PPL Energy Supply had the following foreign currency hedges outstanding.

	2009			2008		
	Exposure Hedged	Fair Value, Net - Asset (Liability)	Effect of a 10% Adverse Movement in Foreign Currency Exchange Rates (a)	Exposure Hedged	Fair Value, Net - Asset (Liability)	Effect of a 10% Adverse Movement in Foreign Currency Exchange Rates (a)
Net investment hedges (b)	£ 40	\$ 13	\$ (6)	£ 68	\$ 34	\$ (10)
Economic hedges (c)	48	2	(4)			

- (a) Effects of adverse movements decrease assets or increase liabilities, as applicable, which could result in an asset becoming a liability.
- (b) To protect the value of a portion of PPL Energy Supply's net investment in WPD, PPL executed forward contracts to sell British pounds sterling. The settlement dates of these contracts range from March 2010 through June 2011.
- c) To economically hedge the translation of 2010 expected income denominated in British pounds sterling to U.S. dollars, PPL entered into a combination of average rate forwards and average rate options to sell British pounds sterling. The forwards and options have termination dates ranging from January 2010 through June 2010.

#### *NDT Funds - Securities Price Risk*

In connection with certain NRC requirements, PPL Susquehanna maintains trust funds to fund certain costs of decommissioning the Susquehanna nuclear station. At December 31, 2009, these funds were invested primarily in domestic equity securities and fixed-rate, fixed-income securities and are reflected at fair value on PPL Energy Supply's Balance Sheet. The mix of securities is designed to provide returns sufficient to fund Susquehanna's decommissioning and to compensate for inflationary increases in decommissioning costs. However, the equity securities included in the trusts are exposed to price fluctuation in equity markets, and the values of fixed-rate, fixed-income securities are exposed to changes in interest rates. PPL actively monitors the investment performance and periodically reviews asset allocation in accordance with its nuclear decommissioning trust policy statement. At December 31, 2009, a hypothetical 10% increase in interest rates and a 10% decrease in equity prices would have resulted in an estimated \$40 million reduction in the fair value of the trust assets, compared with \$27 million at December 31, 2008. See Notes 17 and 21 to the Financial Statements for additional information regarding the NDT funds.

#### *Defined Benefit Plans - Securities Price Risk*

See "Application of Critical Accounting Policies - Defined Benefits" for additional information regarding the effect of securities price risk on plan assets.

#### Credit Risk

Credit risk is the risk that PPL Energy Supply would incur a loss as a result of nonperformance by counterparties of their contractual obligations. PPL Energy Supply maintains credit policies and procedures with respect to counterparty credit (including requirements that counterparties maintain specified credit ratings) and requires other assurances in the form of credit support or collateral in certain circumstances in order to limit counterparty credit risk. However, PPL Energy Supply has concentrations of suppliers and customers among electric utilities, financial institutions and other energy marketing and trading companies. These concentrations may impact PPL Energy Supply's overall exposure to credit risk, positively or negatively, as counterparties may be similarly affected by changes in economic, regulatory or other conditions.

PPL Energy Supply includes the effect of credit risk on its fair value measurements to reflect the probability that a counterparty will default when contracts are out of the money (from the counterparty's standpoint). In this case, PPL Energy Supply would have to sell into a lower-priced market or purchase from a higher-priced market. When necessary, PPL Energy Supply records an allowance for doubtful accounts to reflect the probability that a counterparty will not pay for deliveries PPL Energy Supply has made but not yet billed, which are reflected in "Unbilled revenues" on the Balance Sheets. PPL Energy Supply also has established a reserve with respect to certain sales to the California ISO for which PPL Energy Supply has not yet been paid, which is reflected in accounts receivable on the Balance Sheets. See Note 14 to the Financial Statements for additional information.

See "Overview" in this Item 7 and Notes 15, 17 and 18 to the Financial Statements for additional information on credit concentration and credit risk.

#### **Related Party Transactions**

PPL Energy Supply is not aware of any material ownership interests or operating responsibility by senior management of PPL Energy Supply in outside partnerships, including leasing transactions with variable interest entities, or other entities doing business with PPL Energy Supply.

For additional information on related party transactions, see Note 15 to the Financial Statements.

#### **Acquisitions, Development and Divestitures**

PPL Energy Supply is currently planning incremental capacity increases of 239 MW, primarily at its existing generating facilities. See "Item 2. Properties - Supply Segment" for additional information.

PPL Energy Supply continuously reexamines development projects based on market conditions and other factors to determine whether to proceed with the projects, sell, cancel or expand them, execute tolling agreements or pursue other options.

See Notes 8 and 9 to the Financial Statements for additional information on the more significant activities.

#### **Environmental Matters**

See "Item 1. Business - Environmental Matters" and Note 14 to the Financial Statements for a discussion of environmental matters.

#### **Competition**

See "Item 1. Business - Competition" under the Supply and International Delivery segments and "Item 1A. Risk Factors" for a discussion of competitive factors affecting PPL Energy Supply.

### New Accounting Guidance

See Notes 1 and 22 to the Financial Statements for a discussion of new accounting guidance adopted and pending adoption.

### Application of Critical Accounting Policies

PPL Energy Supply's financial condition and results of operations are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. The following accounting policies are particularly important to the financial condition or results of operations of PPL Energy Supply, and require estimates or other judgments of matters inherently uncertain. Changes in the estimates or other judgments included within these accounting policies could result in a significant change to the information presented in the Financial Statements (these accounting policies are also discussed in Note 1 to the Financial Statements). PPL's senior management has reviewed these critical accounting policies and the estimates and assumptions regarding them with its Audit Committee. In addition, PPL's senior management has reviewed the following disclosures regarding the application of these critical accounting policies with the Audit Committee.

Effective January 1, 2009, PPL Energy Supply fully applied accounting guidance that provides a framework for measuring fair value. The fair value measurement concepts provided by this guidance are used within its financial statements where applicable. See Notes 1 and 17 to the Financial Statements for additional information regarding fair value measurements.

#### **1) Price Risk Management**

See "Risk Management - Energy Marketing & Trading and Other" above and Note 18 to the Financial Statements.

#### **2) Defined Benefits**

PPL Energy Supply subsidiaries sponsor various defined benefit pension and other postretirement plans and participate in and are allocated a significant portion of the liability and net periodic defined benefit costs of plans sponsored by PPL Services based on participation in those plans. PPL Energy Supply subsidiaries record an asset or liability to recognize the funded status of all defined benefit plans with an offsetting entry to OCI. Consequently, the funded status of all defined benefit plans is fully recognized on the Balance Sheets. See Note 12 to the Financial Statements for additional information about the plans and the accounting for defined benefits.

PPL and PPL Energy Supply make certain assumptions regarding the valuation of benefit obligations and the performance of plan assets. When accounting for defined benefits, delayed recognition in earnings of differences between actual results and expected or estimated results is a guiding principle. Annual net periodic defined benefit costs are recorded in current earnings based on estimated results. Any differences between actual and estimated results are recorded in OCI. These amounts in AOCI are amortized to income over future periods. The delayed recognition allows for a smoothed recognition of costs over the working lives of the employees who benefit under the plans. The primary assumptions are:

- **Discount Rate** - The discount rate is used in calculating the present value of benefits, which is based on projections of benefit payments to be made in the future. The objective in selecting the discount rate is to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments, would provide the necessary future cash flows to pay the accumulated benefits when due.
- **Expected Return on Plan Assets** - Management projects the long-term rates of return on plan assets based on historical performance, future expectations and periodic portfolio rebalancing among the diversified asset classes. These projected returns reduce the net benefit costs PPL Energy Supply records currently.
- **Rate of Compensation Increase** - Management projects employees' annual pay increases, which are used to project employees' pension benefits at retirement.
- **Health Care Cost Trend Rate** - Management projects the expected increases in the cost of health care.

In selecting a discount rate for its U.S. defined benefit plans, PPL and PPL Energy Supply start with an analysis of the expected benefit payment stream for its plans. This information is first matched against a spot-rate yield curve. A portfolio of 526 Aa-graded non-callable (or callable with make-whole provisions) bonds, with a total amount outstanding in excess of \$541 billion, serves as the base from which those with the lowest and highest yields are eliminated to develop the ultimate yield curve. The results of this analysis are considered together with other economic data and movements in various bond indices to determine the discount rate assumption. At December 31, 2009, PPL and PPL Energy Supply decreased the discount rate for their U.S. pension plans from 6.50% to 6.00% as a result of this assessment. PPL decreased the discount rate for its other postretirement benefit plans from 6.45% to 5.81% and PPL Energy Supply decreased the discount rate for its other postretirement benefit plans from 6.37% to 5.55%.

A similar process is used to select the discount rate for the U.K. pension plans, which uses an iBoxx British pounds sterling denominated corporate bond index as its base. At December 31, 2009, PPL and PPL Energy Supply decreased the discount rate for the U.K. pension plans from 7.47% to 5.55% as a result of this assessment.

The expected long-term rates of return for PPL and PPL Energy Supply's U.S. defined benefit pension and other postretirement benefit plans



have been developed using a best-estimate of expected returns, volatilities and correlations for each asset class. PPL management corroborates these rates with expected long-term rates of return calculated by its independent actuary, who uses a building block approach that begins with a risk-free rate of return with factors being added such as inflation, duration, credit spreads and equity risk. Each plan's specific asset allocation is also considered in developing a reasonable return assumption.

At December 31, 2009, PPL's expected return on plan assets remained at 8.00% for its U.S. pension plans and remained at 7.00% for PPL's other postretirement benefit plans. PPL Energy Supply's expected return on plan assets increased from 7.78% to 8.00% as a result of the settlement of the PA Mines, LLC Retirement plan, which historically earned a lower rate of return. The expected long-term rates of return for PPL and PPL Energy Supply's U.K. pension plans have been developed by WPD management with assistance from an independent actuary using a best-estimate of expected returns, volatilities and correlations for each asset class. For the U.K. plans, PPL and PPL Energy Supply's expected return on plan assets remained at 7.90% at December 31, 2009.

In selecting a rate of compensation increase, PPL Energy Supply considers past experience in light of movements in inflation rates. At December 31, 2009, PPL and PPL Energy Supply's rate of compensation increase remained at 4.75% for their U.S. plans. For the U.K. plans, PPL and PPL Energy Supply's rate of compensation increase remained at 4.00% at December 31, 2009.

In selecting health care cost trend rates, PPL and PPL Energy Supply consider past performance and forecasts of health care costs. At December 31, 2009, PPL and PPL Energy Supply's health care cost trend rates were 8.00% for 2010, gradually declining to 5.50% for 2016.

A variance in the assumptions listed above could have a significant impact on accrued defined benefit liabilities or assets, reported annual net periodic defined benefit costs and OCI. While the charts below reflect either an increase or decrease in each assumption, the inverse of this change would impact the accrued defined benefit liabilities or assets, reported annual net periodic defined benefit costs and OCI by a similar amount in the opposite direction. The sensitivities below reflect an evaluation of the change based solely on a change in that assumption and does not include income tax effects.

At December 31, 2009, PPL Energy Supply had recorded the following defined benefit plan liabilities:

Pension liabilities	\$	884
Other postretirement benefit liabilities		91

The following chart reflects the sensitivities in the December 31, 2009 Balance Sheet associated with a change in certain assumptions based on PPL's and PPL Energy Supply's primary defined benefit plans.

Actuarial assumption	Change in assumption	Increase (Decrease)	
		Impact on defined benefit liabilities	Impact on OCI
Discount Rate	(0.25)%	\$ 146	\$ (146)
Rate of Compensation Increase	0.25%	18	(18)
Health Care Cost Trend Rate (a)	1.0%	5	(5)

(a) Only impacts other postretirement benefits.

In 2009, PPL Energy Supply was allocated and recognized net periodic defined benefit costs charged to operating expense of \$23 million. This amount represents a \$1 million increase from 2008.

The following chart reflects the sensitivities in the 2009 Statement of Income (excluding income tax effects) associated with a change in certain assumptions based on PPL's and PPL Energy Supply's primary defined benefit plans.

Actuarial assumption	Change in assumption	Impact on defined benefit costs
Discount Rate	(0.25)%	\$ 6
Expected Return on Plan Assets	(0.25)%	9
Rate of Compensation Increase	0.25%	2
Health Care Cost Trend Rate (a)	1.0%	1

(a) Only impacts other postretirement benefits.

### 3) Asset Impairment

PPL Energy Supply performs impairment analyses for long-lived assets that are subject to depreciation or amortization whenever events or changes in circumstances indicate that a long-lived asset's carrying value may not be recoverable. For these long-lived assets to be held and used, such events or changes in circumstances are:

- a significant decrease in the market price of an asset;
- a significant adverse change in the manner in which an asset is being used or in its physical condition;
- a significant adverse change in legal factors or in the business climate;

- an accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of an asset;
- a current-period operating or cash flow loss combined with a history of losses or a forecast that demonstrates continuing losses; or
- a current expectation that, more likely than not, an asset will be sold or otherwise disposed of before the end of its previously estimated useful life.

For a long-lived asset to be held and used, an impairment is recognized when the carrying amount of the asset is not recoverable and exceeds its fair value. The carrying amount is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. If the asset is impaired, an impairment loss is recorded to adjust the asset's carrying value to its estimated fair value. Management must make significant judgments to estimate future cash flows including the useful lives of long-lived assets, the fair value of the assets and management's intent to use the assets. PPL Energy Supply considers alternate courses of action to recover the carrying value of a long-lived asset, and uses estimated cash flows from the "most likely" alternative to assess impairment whenever one alternative is clearly the most likely outcome. If no alternative is clearly the most likely, then a probability-weighted approach is used taking into consideration estimated cash flows from the alternatives. For assets tested for impairment as of the balance sheet date, the estimates of future cash flows used in that test consider the likelihood of possible outcomes that existed at the balance sheet date, including the assessment of the likelihood of a future sale of the assets. That assessment is not revised based on events that occur after the balance sheet date. Changes in assumptions and estimates could result in significantly different results than those identified and recorded in the financial statements.

For a long-lived asset held for sale, an impairment exists when the carrying amount of the asset (disposal group) exceeds its fair value less cost to sell. If the asset (disposal group) is impaired, an impairment loss is recorded to adjust its carrying amount to its fair value less cost to sell. A gain is recognized for any subsequent increase in fair value less cost to sell, but not in excess of the cumulative impairment previously recognized.

For determining fair value, quoted market prices in active markets are the best evidence of fair value. However, when market prices are unavailable, PPL Energy Supply considers all valuation techniques appropriate in the circumstances and for which market participant inputs can be obtained. PPL Energy Supply has generally used discounted cash flows to estimate fair value, which incorporates market participant inputs when available. Discounted cash flows are calculated by estimating future cash flow streams and applying appropriate discount rates to determine the present value of the cash flow streams.

In 2009, PPL Energy Supply recorded impairments of certain long-lived assets. See Note 17 to the Financial Statements for a discussion of impairments related to certain sulfur dioxide emission allowances and the Long Island generation business.

PPL Energy Supply tests goodwill for impairment at the reporting unit level. PPL Energy Supply has determined its reporting units to be at or one level below its operating segments. PPL Energy Supply performs a goodwill impairment test annually or more frequently if events or changes in circumstances indicate that the carrying value of the reporting unit may be greater than the unit's fair value. Additionally, goodwill tested for impairment after a portion of goodwill has been allocated to a business to be disposed of.

Goodwill is tested for impairment using a two-step approach. The first step of the goodwill impairment test compares the estimated fair value of a reporting unit with its carrying amount, including goodwill. If the estimated fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered impaired. If the carrying amount exceeds the estimated fair value of the reporting unit, the second step is performed to measure the amount of impairment loss, if any.

The second step requires a calculation of the implied fair value of goodwill. The implied fair value of goodwill is determined in the same manner as the amount of goodwill in a business combination. That is, the estimated fair value of a reporting unit is allocated to all of the assets and liabilities of that unit as if the reporting unit had been acquired in a business combination and the estimated fair value of the reporting unit was the price paid to acquire the reporting unit. The excess of the estimated fair value of a reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of goodwill. The implied fair value of the reporting unit's goodwill is then compared with the carrying amount of that goodwill. If the carrying amount exceeds the implied fair value, an impairment loss is recognized in an amount equal to that excess. The loss recognized cannot exceed the carrying amount of the reporting unit's goodwill.

In 2009, PPL Energy Supply was not required to impair any goodwill. Management primarily used discounted cash flows, which required significant assumptions, to estimate the fair value of each reporting unit. A decrease in the forecasted cash flows of 10%, or an increase of the discount rate by 25 basis points, would not have resulted in an impairment of goodwill.

Additionally, in 2009, PPL Energy Supply wrote off \$3 million of goodwill allocated to discontinued operations.

#### 4) Loss Accruals

PPL Energy Supply accrues losses for the estimated impacts of various conditions, situations or circumstances involving uncertain or contingent future outcomes. For loss contingencies, the loss must be accrued if (1) information is available that indicates it is probable that a loss has been incurred, given the likelihood of the uncertain future events, and (2) the amount of the loss can be reasonably estimated. Accounting guidance defines "probable" as cases in which "the future event or events are likely to occur." PPL Energy Supply does not record the accrual of contingencies that might result in gains, unless recovery is assured. PPL Energy Supply continuously assesses potential loss contingencies for environmental remediation, litigation claims, regulatory penalties and other events.

The accounting aspects of estimated loss accruals include (1) the initial identification and recording of the loss, (2) the determination of triggering events for reducing a recorded loss accrual, and (3) the ongoing assessment as to whether a recorded loss accrual is sufficient. All three of these aspects require significant judgment by PPL Energy Supply's management. PPL Energy Supply uses its internal expertise and outside experts (such as lawyers and engineers), as necessary, to help estimate the probability that a loss has been incurred and the amount (or

range) of the loss.

No new significant loss accruals were recorded in 2009. In 2008, significant judgment was required by PPL Energy Supply's management to perform an assessment of the contingency related to the Montana hydroelectric litigation.

In June 2008, PPL's management assessed the loss exposure related to the Montana hydroelectric litigation, given the June 2008 decision by the Montana First Judicial District Court (District Court). The District Court awarded compensation of approximately \$34 million for the years 2000 through 2006, and approximately \$6 million for 2007 as rent for the use of the State of Montana's streambeds by PPL Montana's hydroelectric facilities. The District Court also deferred the determination of compensation for 2008 and subsequent years to the Montana State Land Board (Land Board). In October 2008, PPL Montana filed an appeal of the decision to the Montana Supreme Court and a stay of judgment, including a stay of the Land Board's authority to assess compensation against PPL Montana for 2008 and future periods. Oral agreement of the case was held before the Montana Supreme Court in September 2009.

As part of the preparation of its 2009 financial statements, PPL Energy Supply's management reassessed the loss exposure for the Montana hydroelectric litigation. PPL's management concluded, based on its assessment and after consultations with its trial counsel, that it has meritorious arguments on appeal for the years 2000 through 2006. PPL assessed the likelihood of a loss for these years as reasonably possible. However, PPL Montana has not recorded a loss accrual for these years, as the likelihood of a loss was not deemed probable.

For 2007 and subsequent years, PPL's management believes that while it also has meritorious arguments, it is probable that its hydroelectric projects will be subject to annual estimated compensation ranging from \$3 million to \$6 million. Given that there was no single amount within that range more likely than any other, PPL Montana accrued \$3 million for each of the years 2007 through 2009 for a total of \$9 million. See Note 14 to the Financial Statements for additional information on this contingency.

PPL Energy Supply has identified certain other events that could give rise to a loss, but that do not meet the conditions for accrual. Such events are disclosed, but not recorded, when it is "reasonably possible" that a loss has been incurred. See Note 14 to the Financial Statements for disclosure of other potential loss contingencies that have not met the criteria for accrual.

When an estimated loss is accrued, PPL Energy Supply identifies, where applicable, the triggering events for subsequently reducing the loss accrual. The triggering events generally occur when the contingency has been resolved and the actual loss is incurred, or when the risk of loss has diminished or been eliminated. The following are some of the triggering events that provide for the reduction of certain recorded loss accruals:

- Allowances for uncollectible accounts are reduced when accounts are written off after prescribed collection procedures have been exhausted, a better estimate of the allowance is determined or underlying amounts are ultimately collected.
- Environmental and other litigation contingencies are reduced when the contingency is resolved and PPL Energy Supply makes actual payments, a better estimate of the loss is determined or the loss is no longer considered probable.

PPL Energy Supply reviews its loss accruals on a regular basis to assure that the recorded potential loss exposures are appropriate. This involves ongoing communication and analyses with internal and external legal counsel, engineers, operation management and other parties.

## 5) Asset Retirement Obligations

PPL Energy Supply is required to recognize a liability for legal obligations associated with the retirement of long-lived assets. The initial obligation should be measured at its estimated fair value. An equivalent amount should be recorded as an increase in the value of the capitalized asset and allocated to expense over the useful life of the asset. Until the obligation is settled, the liability should be increased, through the recognition of accretion expense in the income statement, for changes in the obligation due to the passage of time. A conditional ARO must be recognized when incurred if the fair value of the ARO can be reasonably estimated.

In determining AROs, management must make significant judgments and estimates to calculate fair value. Fair value is developed using an expected present value technique based on assumptions of market participants that considers estimated retirement costs in current period dollars that are inflated to the anticipated retirement date and then discounted back to the date the ARO was incurred. Changes in assumptions and estimates included within the calculations of the fair value of AROs could result in significantly different results than those identified and recorded in the financial statements. Estimated ARO costs and settlement dates, which affect the carrying value of various AROs and the related assets, are reviewed periodically to ensure that any material changes are incorporated into the latest estimate of the obligations.

At December 31, 2009, PPL Energy Supply had AROs totaling \$426 million recorded on the Balance Sheet, of which \$10 million is included in "Other current liabilities." Of the total amount, \$348 million, or 82%, relates to PPL Energy Supply's nuclear decommissioning ARO. The most significant assumptions surrounding AROs are the forecasted retirement costs, the discount rates and the inflation rates. A variance in the forecasted retirement costs, the discount rates or the inflation rates could have a significant impact on the ARO liabilities.

The following chart reflects the sensitivities related to PPL Energy Supply's nuclear decommissioning ARO liability as of December 31, 2009, associated with a change in these assumptions at the time of initial recognition. There is no significant change to the annual depreciation expense of the ARO asset or the annual accretion expense of the ARO liability as a result of changing the assumptions. The sensitivities below reflect an evaluation of the change based solely on a change in that assumption.

**Change in Assumption**

**Impact on ARO Liability**

Retirement Cost	10%/(10)%	\$32/\$(32)
Discount Rate	0.25%/(0.25)%	\$(31)/\$34
Inflation Rate	0.25%/(0.25)%	\$41/\$(37)

### **Income Tax Uncertainties**

Significant management judgment is required in developing PPL Energy Supply's provision for income taxes primarily due to the uncertainty related to tax positions taken or expected to be taken in tax returns and the determination of deferred tax assets, liabilities and valuation allowances.

Significant management judgment is required to determine the amount of benefit recognized related to an uncertain tax position. PPL Energy Supply evaluates its tax positions following a two-step process. The first step requires an entity to determine whether, based on the technical merits supporting a particular tax position, it is more likely than not (greater than a 50% chance) that the tax position will be sustained. This determination assumes that the relevant taxing authority will examine the tax position and is aware of all the relevant facts surrounding the tax position. The second step requires an entity to recognize in the financial statements the benefit of a tax position that meets the more-likely-than-not recognition criterion. The benefit recognized is measured at the largest amount of benefit that has a likelihood of realization, upon settlement, that exceeds 50%. PPL Energy Supply's management considers a number of factors in assessing the benefit to be recognized, including negotiation of a settlement.

On a quarterly basis, PPL Energy Supply reassesses its uncertain tax positions by considering information known at the reporting date. Based on management's assessment of new information, PPL Energy Supply may subsequently recognize a tax benefit for a previously unrecognized tax position, de-recognize a previously recognized tax position, or re-measure the benefit of a previously recognized tax position. The amounts ultimately paid upon resolution of issues raised by taxing authorities may differ materially from the amounts accrued and may materially impact PPL Energy Supply's financial statements in the future.

The balance sheet classification of unrecognized tax benefits and the need for valuation allowances to reduce deferred tax assets also require significant management judgment. PPL Energy Supply classifies unrecognized tax benefits as current, to the extent management expects to settle an uncertain tax position, by payment or receipt of cash, within one year of the reporting date. Valuation allowances are initially recorded and reevaluated each reporting period by assessing the likelihood of the ultimate realization of a deferred tax asset. Management considers a number of factors in assessing the realization of a deferred tax asset, including the reversal of temporary differences, future taxable income and ongoing prudent and feasible tax planning strategies. Any tax planning strategy utilized in this assessment must meet the recognition and measurement criteria utilized by PPL Energy Supply to account for an uncertain tax positions. See Note 5 to the Financial Statements for the required disclosures.

As of December 31, 2009, it was reasonably possible that during the next 12 months the total amount of unrecognized tax benefits could increase by as much as \$11 million or decrease by up to \$123 million for PPL Energy Supply. This change could result from subsequent recognition, derecognition and/or changes in the measurement of uncertain tax positions related to the creditability of foreign taxes, the timing and utilization of foreign tax credits and the related impact on alternative minimum tax and other credits, the timing and/or valuation of certain deductions, intercompany transactions and unitary filing groups. The events that could cause these changes are direct settlements with taxing authorities, litigation, legal or administrative guidance by relevant taxing authorities and the lapse of an applicable statute of limitation.

### **Other Information**

PPL's Audit Committee has approved the independent auditor to provide audit and audit-related services and other services permitted by Sarbanes-Oxley and SEC rules. The audit and audit-related services include services in connection with statutory and regulatory filings, reviews of offering documents and registration statements, and internal control reviews. See "Item 14. Principal Accounting Fees and Services" for more information.

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## PPL ELECTRIC UTILITIES CORPORATION AND SUBSIDIARIES

### Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

#### Overview

PPL Electric is an electricity delivery service provider in eastern and central Pennsylvania with headquarters in Allentown, Pennsylvania. Refer to "Item 1. Business - Background" for a description of its business. PPL Electric's strategy and principal challenge is to own and operate its electricity delivery business at the most efficient cost while maintaining high quality customer service and reliability.

PPL Electric's electricity delivery business is rate-regulated. Accordingly, this business is subject to regulatory risk with respect to costs that may be recovered and investment returns that may be collected through customer rates. See "Customer Choice - End of Transition Period" below for information on additional risks PPL Electric may face.

In order to manage financing costs and access to credit markets, a key objective for PPL Electric's business as a whole is to maintain a strong credit profile. PPL Electric continually focuses on maintaining an appropriate capital structure and liquidity position.

See "Item 1A. Risk Factors" for more information concerning these and other material risks PPL Electric faces in its business.

The purpose of "Management's Discussion and Analysis of Financial Condition and Results of Operations" is to provide information concerning PPL Electric's performance in implementing the strategies and managing the risks and challenges mentioned above. Specifically:

- "Results of Operations" provides an overview of PPL Electric's operating results in 2009, 2008 and 2007, including a review of earnings. It also provides a brief outlook for 2010.
- "Financial Condition - Liquidity and Capital Resources" provides an analysis of PPL Electric's liquidity position and credit profile, including its sources of cash (including bank credit facilities and sources of operating cash flow) and uses of cash (including contractual obligations and capital expenditure requirements) and the key risks and uncertainties that impact PPL Electric's past and future liquidity position and financial condition. This subsection also includes a listing and discussion of PPL Electric's current credit ratings.
- "Financial Condition - Risk Management" provides an explanation of PPL Electric's risk management programs relating to market risk and credit risk.
- "Application of Critical Accounting Policies" provides an overview of the accounting policies that are particularly important to the results of operations and financial condition of PPL Electric and that require its management to make significant estimates, assumptions and other judgments.

The information provided in this Item 7 should be read in conjunction with PPL Electric's Consolidated Financial Statements and the accompanying Notes.

Terms and abbreviations are explained in the glossary. Dollars are in millions unless otherwise noted.

#### **Customer Choice – End of Transition Period**

In 1996, the Customer Choice Act was enacted to restructure Pennsylvania's electric utility industry in order to create retail access to a competitive market for generation of electricity. The Customer Choice Act required each Pennsylvania electric utility, including PPL Electric, to file a restructuring plan to "unbundle" its rates into separate generation, transmission and distribution components and to permit its customers to directly access alternate suppliers of electricity. Under the Customer Choice Act, PPL Electric was required to act as a PLR. As part of a settlement approved by the PUC and in connection with the restructuring plan PPL Electric filed under the Customer Choice Act, PPL Electric agreed to provide electricity as a PLR at predetermined "capped" rates through 2009. In addition, the PUC authorized recovery of approximately \$2.97 billion of competitive transition or "stranded" costs (generation-related costs that might not otherwise be recovered in a competitive market) from customers during an 11-year transition period. For PPL Electric, this transition period ended on December 31, 2009.

As a result of the PUC settlement order and the PLR obligation, PPL Electric, through 2009, generally bore the risk that it would not be able to obtain adequate energy supply at the "capped" rates it could charge to its customers who did not select an alternate electricity supplier. To mitigate this risk, PPL Electric entered into full requirements energy supply agreements with PPL EnergyPlus, a PPL Electric affiliate. Under these agreements, through 2009, PPL EnergyPlus supplied PPL Electric's entire PLR load at predetermined prices equal to the capped generation rates that PPL Electric was authorized to charge its customers.

Related to PPL Electric's transition period, the following has occurred or will occur:

- In August 1999, CTC of \$2.4 billion were converted to intangible transition costs when they were securitized by the issuance of transition bonds. The intangible transition costs were amortized over the life of the transition bonds, through December 2008, in accordance with an amortization schedule filed with the PUC. These transition bonds matured in tranches, with the final tranche being repaid in December 2008.
- During the transition period, PPL Electric was authorized by the PUC to bill its customers \$130 million for a portion of the costs associated with decommissioning of PPL's Susquehanna nuclear plant. Under the power supply agreements between PPL Electric and PPL

EnergyPlus, these revenues were passed on to PPL EnergyPlus. Similarly, these revenues were passed on to PPL Susquehanna under a power supply agreement between PPL EnergyPlus and PPL Susquehanna and invested in the NDT funds. Effective January 1, 2010, these ratepayer billings have ceased.

In December 2009, PPL Electric filed with the PUC a final reconciliation of CTC and ITC recoveries during the transition period. At December 31, 2009, PPL Electric has recorded a net regulatory liability of \$33 million related to these recoveries. The net overcollection will be reflected in customer rates in 2010.

- At December 31, 2009, PPL Electric's long-term power purchase agreements with PPL EnergyPlus (effective since 2000 and 2002) expired.
- To mitigate 2010 rate increases, PPL Electric implemented two programs in 2008 and 2009 that allowed customers to make prepayments toward their 2010 and 2011 electric bills or to defer any 2010 electric bill increases exceeding 25%. Any deferred amounts are to be repaid by 2012. At December 31, 2009, PPL Electric has recorded a liability of \$36 million for these programs.
- Effective January 1, 2010, PPL Electric's rates for generation supply as a PLR are no longer capped and the cost of electric generation is based on a competitive solicitation process. During 2007 through 2009, PPL Electric procured through PUC-approved solicitation procedures, the electric generation supply it will need in 2010 for customers who do not choose an alternative supplier. The prices in these contracts will result in an average residential customer paying approximately 30% higher rates, as compared to the previously-capped rates on delivered electricity. PPL Electric is currently procuring the PLR supply it will need for the January 2011 through May 2013 period. The results of all procurements continue to require the approval of the PUC.
- For those customers who choose to procure generation supply from alternative providers, PPL Electric will provide services for these alternative generation suppliers to bill usage charges, among other duties. As required by a PUC-approved plan, PPL Electric will be purchasing certain receivables from alternative suppliers at a discount.

In October 2008, Act 129 became effective. This law created requirements for energy efficiency and conservation programs and for the use of smart metering technology, imposed new PLR electricity supply procurement rules, provided remedies for market misconduct, and made changes to the existing Alternative Energy Portfolio Standard.

Prior to the expiration of the generation rate caps, customers' interest in purchasing generation supply from other providers was limited because in recent years, the long-term supply agreement between PPL Electric and PPL EnergyPlus provided a below-market cost of generation supply for these customers. As a result, a limited amount of "shopping" occurred. In 2010, several alternative suppliers have offered to provide generation supply in PPL Electric's service territory. When its customers purchase supply from these alternative suppliers or from PPL Electric's PLR, the purchase of such supply has no significant impact on the operating results of PPL Electric. The cost to purchase PLR supply is passed directly by PPL Electric to its customers without markup. For those customers who receive their supply from an alternative supplier, PPL Electric may act as billing agent or the alternative supplier may bill for their supply directly, and in either case, PPL Electric does not record revenues or expenses related to this supply. PPL Electric remains the distribution provider for all the customers in its service territory and charges a regulated rate for the service of delivering that electricity.

Lower demand for electric power due to increased prices, the economic downturn or the conservation provisions of Act 129 that require PPL Electric to reduce its customers' electricity usage in future periods, could impact future revenues. The reduction in volume could be offset by changes in customer rates for this service, subject to PUC approval, depending on PPL Electric's cost structure. Act 129 includes one-time penalties of up to \$20 million for not attaining the required reductions by 2011 and 2013. At this time, PPL Electric expects to meet these targeted reductions. The costs of complying with the other provisions of Act 129 would, subject to PUC approval, be recoverable through an automatic adjustment clause. None of the above changes are expected to have a significant impact on PPL Electric's 2010 financial condition, operating results or cash flows.

The final expiration of generation rate caps in Pennsylvania, applicable to three other large regulated utilities, is scheduled to occur at the end of 2010. Discussions concerning generation rate caps and rate increase mitigation are continuing. The final result of those discussions and the future impact on the financial condition and future cash flows of PPL Electric cannot be predicted at this time.

See Note 14 to the Financial Statements for additional information on Pennsylvania legislative and other regulatory activities.

## **Market Events**

In 2008, conditions in the financial markets became disruptive to the processes of managing credit risk, responding to liquidity needs, measuring financial instruments at fair value, and managing market price risk. Bank credit capacity was reduced and the cost of renewing or establishing new credit facilities increased, thereby introducing uncertainties as to PPL Electric's ability to reliably estimate the longer-term cost and availability of credit. In general, bank credit capacity has increased from the significantly constrained levels of 2008 and early 2009. In addition, the cost of renewing or establishing new credit facilities has improved when compared with the 2008 and early 2009 periods.

## **Credit Risk**

Credit risk is the risk that PPL Electric would incur a loss as a result of nonperformance by counterparties of their contractual obligations. PPL Electric maintains credit policies and procedures to limit counterparty credit risk. Conditions in the financial and commodity markets have generally increased PPL Electric's exposure to credit risk. See Notes 15, 17 and 18 to the Financial Statements, and "Risk Management - Credit Risk" for more information on credit risk.

## Liquidity Risk

PPL Electric expects to continue to have access to adequate sources of liquidity through operating cash flows, cash and cash equivalents, credit facilities and, from time to time, the issuance of capital market securities. PPL Electric's ability to access capital markets may be impacted by conditions in the overall financial and capital markets, as well as conditions specific to the utility sector. See "Financial Condition - Liquidity and Capital Resources" for an expanded discussion of PPL Electric's liquidity position and a discussion of its forecasted sources of cash.

## Securities Price Risk

PPL Electric participates in and is allocated costs from defined benefit plans sponsored by PPL. Declines in the market price of debt and equity securities result in unrealized losses that reduce the asset values of PPL's defined benefit plans. PPL's defined benefit plans earned positive returns in the second half of 2009, thereby recovering a portion of the negative returns incurred in 2008 and the first quarter of 2009.

Determination of the funded status of defined benefit plans, contribution requirements and net periodic defined benefit costs for future years are subject to changes in various assumptions, in addition to the actual performance of the assets in the plans. See "Application of Critical Accounting Policies - Defined Benefits" for a discussion of the assumptions and sensitivities regarding those assumptions.

## The Economic Stimulus Package

The Economic Stimulus Package was intended to stimulate the U.S. economy through federal tax relief, expansion of unemployment benefits and other social stimulus provisions, domestic spending for education, health care and infrastructure, including the energy sector. A portion of the benefits included in the Economic Stimulus Package are offered in the form of loan fee reductions, expanded loan guarantees and secondary market incentives.

Funds from the Economic Stimulus Package have been allocated to various federal agencies, such as the DOE, and provided to state agencies through block grants. The DOE has made awards of the funds for smart grid and efficiency-related programs. In addition, in July 2009, PPL Electric proposed to the DOE that the agency provide funding for one-half of a \$38 million smart grid project. The project would use smart grid technology to strengthen reliability, save energy and improve electric service for 60,000 Harrisburg, Pennsylvania area customers. It would also provide benefits beyond the Harrisburg region, helping to speed power restoration across PPL Electric's 29-county service territory. In October 2009, PPL Electric received notification that its grant proposal had been selected by the DOE for award negotiations. PPL Electric cannot predict the outcome of these award negotiations.

## Results of Operations

### **Earnings**

Income available to PPL was:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
	\$ 124	\$ 158	\$ 145

The changes in income available to PPL from year to year were, in part, attributable to several special items that management considers significant. Details of these special items are provided below.

The after-tax changes in income available to PPL between these periods were due to the following factors.

	<u>2009 vs. 2008</u>	<u>2008 vs. 2007</u>
Delivery revenues (net of CTC/ITC amortization, interest expense on transition bonds and ancillary charges)	\$ (16)	\$ 32
Other operation and maintenance	3	(8)
Other income - net (a)	(2)	(10)
Interest expense	(12)	1
Other	2	(3)
Special items	(9)	1
	<u>\$ (34)</u>	<u>\$ 13</u>

(a) Includes interest income from affiliate.

- Delivery revenues decreased in 2009 compared with 2008, primarily due to unfavorable economic conditions, including industrial customers scaling back on production and the unfavorable impact of weather on sales volumes. See "Revenue Recognition" in Note 1 to the Financial Statements for information on a true-up of FERC formula-based transmission revenues.

Delivery revenues increased in 2008 compared with 2007, primarily due to a base rate increase effective January 1, 2008 and normal load growth.

- Other operation and maintenance expenses increased in 2008 compared with 2007, primarily due to insurance recovery of storm costs in 2007, higher vegetation management costs and higher regulatory asset amortization.

Other income - net decreased in 2008 compared with 2007, primarily due to a decrease in interest income from affiliate resulting from a decrease in the average balance outstanding on a note receivable from an affiliate and a lower average floating interest rate.

- Interest expense increased in 2009 compared with 2008, primarily due to \$400 million of debt issuances in October 2008 that prefunded a portion of August 2009 debt maturities.

The following after-tax amounts, which management considers special items, also impacted earnings.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Impairments	\$ (1)		
Workforce reduction (a)	(5)		\$ (1)
Other			
Change in tax accounting method related to repairs (Note 5)	(3)		
Total	<u>\$ (9)</u>		<u>\$ (1)</u>

(a) See Note 12 to the Financial Statements for additional information related to the 2009 workforce reduction.

PPL Electric's earnings beyond 2009 are subject to various risks and uncertainties. See "Forward-Looking Information," "Item 1A. Risk Factors," the rest of this Item 7 and Note 14 to the Financial Statements for a discussion of the risks, uncertainties and factors that may impact PPL Electric's future earnings.

#### *2010 Outlook*

Excluding special items, PPL Electric projects lower earnings in 2010 compared with 2009, as a net result of lower distribution revenues, primarily due to continued slow economic growth and weak customer demand; higher operation and maintenance expenses; offset by lower financing costs.

In late March 2010, PPL Electric expects to file a request with the PUC seeking an increase in its distribution rates beginning in January 2011.

See Note 14 to the Financial Statements for a discussion of items that could impact future earnings, including Pennsylvania legislative and other regulatory activities.

#### **Statement of Income Analysis --**

##### **Operating Revenues**

###### Retail Electric

The changes in revenues from retail electric operations were attributable to:

	<u>2009 vs. 2008</u>	<u>2008 vs. 2007</u>
Delivery	\$ (60)	\$ 17
PLR	(20)	19
Other	9	3
	<u>\$ (71)</u>	<u>\$ 39</u>

The decrease in retail electric revenues for 2009 compared with 2008 was attributable to unfavorable economic conditions, including industrial customers scaling back on production. In addition, weather had an unfavorable impact on sales volumes. These decreases were partially offset by favorable price increases. See "Revenue Recognition" in Note 1 to the Financial Statements for information on a true-up of FERC formula-based transmission revenues.

The increase in PLR revenue for 2008 compared with 2007 was attributable to normal load growth, as well as a favorable price increase. The increase in delivery revenue for the same period was primarily due to a base rate increase effective January 1, 2008, and normal load growth. These increases were partially offset by the unfavorable impact of weather on residential and commercial sales in 2008.

###### Wholesale Electric to Affiliate

PPL Electric has a contract to sell to PPL EnergyPlus the electricity that PPL Electric purchases under contracts with NUGs. The decrease of \$38 million in wholesale electric to affiliate in 2009 compared with 2008 was primarily due to the expiration of NUG contracts in 2008 and 2009. The final NUG contract will expire in 2014.



The decrease of \$48 million in wholesale electric to affiliate in 2008 compared with 2007 was primarily due to the expiration of a NUG contract at the end of 2007 and the expiration of two NUG contracts during 2008. The decrease was partially offset by higher prices on certain NUG contracts.

### Energy Purchases

Energy purchases decreased by \$49 million for 2009 compared with 2008, primarily due to the expiration of NUG contracts in 2008 and 2009, as well as lower ancillary charges, which are primarily the result of lower pricing. The final NUG contract will expire in 2014.

Energy purchases decreased by \$43 million for 2008 compared with 2007, primarily due to the expiration of a NUG contract at the end of 2007 and two NUG contracts in 2008, partially offset by higher prices on certain NUG contracts.

### Energy Purchases from Affiliate

Energy purchases from affiliate decreased by \$20 million in 2009 compared with 2008. The decrease was attributable to unfavorable weather and the impact of economic conditions, primarily on industrial customers' load, partially offset by higher prices for energy purchased under the power supply contracts with PPL EnergyPlus that support the PLR load.

Energy purchases from affiliate increased by \$16 million in 2008 compared with 2007. The increase was primarily due to higher prices for energy purchased under the power supply contracts with PPL EnergyPlus that support the PLR load, as well as higher PLR load.

### Other Operation and Maintenance

The increases in other operation and maintenance expense were due to:

	<u>2009 vs. 2008</u>	<u>2008 vs. 2007</u>
Workforce reduction (Note 12)	\$ 9	
Uncollectible accounts	7	\$ 1
Employee benefits	5	(6)
Insurance recovery of storm costs	3	5
Payroll-related costs	3	(3)
Regulatory asset amortization		4
PUC-reportable storm costs	(11)	(4)
Vegetation management costs	(5)	5
Contractor-related expenses	(2)	1
Customer education programs	(2)	
Other		5
	<u>\$ 7</u>	<u>\$ 8</u>

### Amortization of Recoverable Transition Costs

Amortization of recoverable transition costs increased by \$11 million in 2009 compared with 2008 and decreased by \$17 million in 2008 compared with 2007. The amortization of recoverable transition costs was based on a PUC amortization schedule, adjusted for ITC and CTC recoveries in customer rates and related expenses. Since the amortization substantially matches the revenue recorded based on recovery in customer rates, there is minimal impact on earnings. At the end of 2009, PPL Electric's recoverable transition costs have been fully amortized.

### Taxes, Other Than Income

Taxes, other than income decreased by \$9 million in 2009 compared with 2008. The decrease was primarily due to a \$12 million decrease in Pennsylvania gross receipts tax expense, which reflects a decrease in the tax rate in 2009. Gross receipts tax is passed through to customers.

Taxes, other than income increased by \$3 million in 2008 compared with 2007. The increase was primarily due to a \$6 million increase in Pennsylvania gross receipts tax expense, which reflects an increase in the tax rate in 2008.

### Other Income - net

See Note 16 to the Financial Statements for details of other income.

### Interest Income from Affiliate

Interest income from affiliate decreased by \$5 million in 2009 compared with 2008, and decreased by \$10 million in 2008 compared with 2007. These decreases were the result of a reduced average balance outstanding on a note receivable from an affiliate and a lower average rate on this note due to the floating interest rate.

### Interest Expense

The changes in interest expense, which includes "Interest Expense" and "Interest Expense with Affiliate," were due to:

	<u>2009 vs. 2008</u>	<u>2008 vs. 2007</u>
Long-term debt interest expense (a)	\$ 24	\$ 7
Prepayment of transition bonds	(13)	(22)
Interest on PLR contract collateral (Note 15)	(8)	(7)
Other	4	(2)
	<u>\$ 7</u>	<u>\$ (24)</u>

(a) The increases were primarily due to \$400 million of debt issuances in October 2008 that prefunded a portion of August 2009 debt maturities.

### Income Taxes

The changes in income taxes were due to:

	<u>2009 vs. 2008</u>	<u>2008 vs. 2007</u>
Higher (lower) pre-tax book income	\$ (19)	\$ 16
Tax return adjustments (a)	(2)	7
Tax reserve adjustments	(2)	(1)
Other		(3)
	<u>\$ (23)</u>	<u>\$ 19</u>

(a) During 2009, PPL Electric received consent from the IRS to change its method of accounting for certain expenditures for tax purposes. PPL deducted the resulting IRC Sec. 481 adjustment on its 2008 tax return and recorded a \$3 million adjustment to federal and state income tax expense which results from the reversal of prior years' state income tax benefits related to regulated depreciation.

See Note 5 to the Financial Statements for additional information on income taxes.

### Financial Condition

#### Liquidity and Capital Resources

PPL Electric continues to focus on maintaining a strong credit profile and liquidity position. PPL Electric expects to continue to have adequate liquidity available through operating cash flows, cash and cash equivalents and its credit facilities. PPL Electric currently does not plan to access commercial paper markets or debt and equity capital markets in 2010.

PPL Electric's cash flows from operations and access to cost-effective bank and capital markets are subject to risks and uncertainties including, but not limited to:

- unusual or extreme weather that may damage PPL Electric's transmission and distribution facilities or affect energy sales to customers;
- the ability to recover and the timeliness and adequacy of recovery of costs associated with regulated utility businesses;
- any adverse outcome of legal proceedings and investigations with respect to PPL Electric's current and past business activities;
- deterioration in the financial markets that could make obtaining new sources of bank and capital markets funding more difficult and more costly; and
- a downgrade in PPL Electric's credit ratings that could adversely affect its ability to access capital and increase the cost of credit facilities and any new debt.

See "Item 1A. Risk Factors" for further discussion of risks and uncertainties affecting PPL Electric's cash flows.

At December 31, PPL Electric had the following:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Cash and cash equivalents	<u>\$ 485</u>	<u>\$ 483</u>	<u>\$ 33</u>
Short-term debt		<u>\$ 95</u>	<u>\$ 41</u>

The changes in PPL Electric's cash and cash equivalents position resulted from:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Net Cash Provided by Operating Activities	\$ 294	\$ 648	\$ 568
Net Cash Provided by (Used in) Investing Activities	6	(226)	(239)

Net Cash Provided by (Used in) Financing Activities	(298)	28	(446)
Net Increase (Decrease) in Cash and Cash Equivalents	<u>\$ 2</u>	<u>\$ 450</u>	<u>\$ (117)</u>

#### Operating Activities

Net cash provided by operating activities decreased by 55%, or \$354 million, in 2009 compared with 2008, primarily as a result of the repayment by PPL Electric of \$300 million in cash collateral related to the long-term PLR energy supply agreements with PPL Energy Supply, which expired at the end of 2009. The decrease also reflects the impact of lower delivery revenues and higher payments of interest and income taxes.

Net cash provided by operating activities increased by 14%, or \$80 million, in 2008 compared with 2007, primarily as a result of increased revenues, which was due primarily to a base rate increase effective January 1, 2008 and normal load growth, as well as less interest incurred on long-term debt, as a result of the repayment of transition bonds during 2007 and 2008. The increases to cash provided by operating activities resulting from these items were partially offset by increased energy purchases, primarily as a result of higher prices for energy purchased from PPL EnergyPlus under the PLR contracts and higher PLR load, as well as an insurance recovery of storm costs in 2007.

PPL Electric expects to be able to achieve relatively stable cash flows from operations through the support of (i) contracts it has entered into to procure the 2010 and a portion of 2011 PLR electricity supply it expects to need for residential, small commercial and small industrial customers who do not choose an alternative supplier and (ii) purchasing receivables from alternative suppliers for those customers who purchase generation from other suppliers. See Note 14 to the Financial Statements for information on the energy purchase contracts and "Customer Choice - End of Transition Period" in "Overview" in this Item 7 for a discussion of the ability of customers to purchase generation supply from other providers and PPL Electric's purchase of the related receivables.

#### Investing Activities

The primary use of cash in investing activities is capital expenditures. See "Forecasted Uses of Cash" for detail regarding capital expenditures in 2009 and projected expenditures for the years 2010 through 2012.

Net cash provided by investing activities was \$6 million in 2009 compared with cash used in investing activities of \$226 million in 2008. The change from 2008 to 2009 primarily reflects the receipt of \$300 million from an affiliate as repayment of a demand loan.

Net cash used in investing activities remained relatively stable in 2008 compared with 2007, but there were significant changes in certain components. In 2008, there was a net decrease of \$69 million in restricted cash and cash equivalents compared to a net increase of \$8 million in 2007. Capital expenditures decreased \$18 million in 2008 compared with 2007. In 2008, PPL Electric loaned \$23 million to an affiliate compared with receiving \$23 million in 2007 from an affiliate as partial repayment of a demand loan. Additionally, PPL Electric received net proceeds of \$25 million from purchases and sales of investments in 2007 compared with none in 2008.

#### Financing Activities

Net cash used in financing activities was \$298 million in 2009 compared with net cash provided by financing activities of \$28 million in 2008. The change from 2008 to 2009 primarily reflects less issuances and increased retirements of long-term debt, contributions received from PPL, increased common stock dividends to PPL and the repayment of short-term borrowings in 2009. PPL Electric had net debt retirements of \$392 million in 2009 compared with net debt issuances of \$148 million in 2008, received \$400 million of contributions from PPL in 2009 and paid \$176 million more of common stock dividends to PPL in 2009 compared to 2008.

Net cash provided by financing activities was \$28 million in 2008 compared with net cash used in financing activities of \$446 million in 2007. The change from 2007 to 2008 primarily reflects increased issuances and less retirements of long-term debt, less common stock dividends to PPL and increased short-term borrowings in 2008. PPL Electric had net debt issuances of \$148 million in 2008 compared to net debt retirements of \$306 million in 2007, and it paid \$21 million less of common stock dividends to PPL in 2008 compared to 2007.

See "Forecasted Sources of Cash" for a discussion of PPL Electric's plans to issue debt and equity securities, as well as a discussion of credit facility capacity available to PPL Electric. Also see "Forecasted Uses of Cash" for a discussion of PPL Electric's plans to pay dividends on its common and preferred securities, as well as maturities of PPL Electric's long-term debt.

PPL Electric's debt financing activity in 2009 was:

	<u>Issuance</u>	<u>Retirements</u>
Senior Secured Bonds (a)	\$ 298	\$ (586)
Variable Rate Pollution Control Facilities Note		(9)
Short-term debt		(95)
Total	<u>\$ 298</u>	<u>\$ (690)</u>
Net decrease		<u>\$ (392)</u>

(a) Issuance is net of pricing discount. Retirements exclude a \$9 million premium paid in connection with the December 2009 redemption of PPL Electric's 4.30% Senior Secured Bonds due 2013.

See Note 7 to the Financial Statements for more detailed information regarding PPL Electric's financing activities in 2009.

### Forecasted Sources of Cash

PPL Electric expects to continue to have significant sources of cash available in the near term, including various credit facilities and a commercial paper program. PPL Electric currently does not plan to access commercial paper markets or debt and equity capital markets in 2010, but may decide to do so, subject to market conditions, to enhance its liquidity.

### *Credit Facilities*

At December 31, 2009, PPL Electric's total committed borrowing capacity under its credit facilities and the use of this borrowing capacity were:

	<u>Committed Capacity</u>	<u>Borrowed</u>	<u>Letters of Credit Issued (d)</u>	<u>Unused Capacity</u>
5-year Syndicated Credit Facility (a)	\$ 190		\$ 6	\$ 184
Asset-backed Credit Facility (b)	150			150
Total PPL Electric Credit Facilities (c)	<u>\$ 340</u>		<u>\$ 6</u>	<u>\$ 334</u>

- (a) The commitments under this credit facility are provided by a diverse bank group, with no one bank and its affiliates providing an aggregate commitment of more than 18% of the total committed capacity.

Borrowings under this credit facility generally bear interest at LIBOR-based rates plus a spread, depending upon the company's public debt rating. PPL Electric also has the capability to request the lenders to issue up to \$190 million of letters of credit under this facility, which issuances reduce available borrowing capacity. Under certain conditions, PPL Electric may request that the facility's capacity be increased by up to \$100 million.

This credit facility contains a financial covenant requiring debt to total capitalization to not exceed 70%. At December 31, 2009 and 2008, PPL Electric's consolidated debt to total capitalization percentages, as calculated in accordance with its credit facility, were 44% and 53%. This credit facility also contains standard representations and warranties that must be made for PPL Electric to borrow under it.

- (b) This credit facility relates to an asset-backed commercial paper program through which PPL Electric obtains financing by selling and contributing its eligible accounts receivable and unbilled revenues to a special purpose, wholly owned subsidiary on an ongoing basis. The subsidiary pledges these assets to secure loans of up to an aggregate of \$150 million from a commercial paper conduit sponsored by a financial institution. At December 31, 2009, based on accounts receivable and unbilled revenue pledged, \$150 million was available for borrowing.
- (c) The committed capacity expires as follows: \$150 million in 2010 and \$190 million in 2012. PPL Electric intends to renew its existing \$150 million asset-backed credit facility in 2010 in order to maintain its current total committed capacity level.
- (d) PPL Electric has a reimbursement obligation to the extent any letters of credit are drawn upon.

In addition to the financial covenant noted in the table above, the credit agreements governing the credit facilities contain various other covenants. Failure to comply with the covenants after applicable grace periods could result in acceleration of repayment of borrowings and/or termination of the agreements. PPL Electric monitors compliance with the covenants on a regular basis. At December 31, 2009, PPL Electric was in material compliance with these covenants. At this time, PPL Electric believes that these covenants and other borrowing conditions will not limit access to these funding sources.

See Note 7 to the Financial Statements for further discussion of PPL Electric's credit facilities.

### *Commercial Paper*

PPL Electric maintains a commercial paper program for up to \$200 million to provide an additional financing source to fund its short-term liquidity needs, if and when necessary. Commercial paper issuances are supported by PPL Electric's five-year syndicated credit facility based on available capacity.

As noted below under "Credit Ratings," commercial paper for PPL Electric is rated P-2, A-2 and F2 by Moody's, S&P and Fitch. Market conditions to issue commercial paper with these ratings have strengthened significantly since 2008, when the downturn in the financial markets created extremely limited liquidity resulting in high borrowing rates. PPL Electric did not issue any commercial paper during 2009. Based on its current cash position and anticipated cash flows, PPL Electric currently does not plan to issue any commercial paper during 2010, but it may do so from time to time, subject to market conditions, to facilitate short-term cash flow needs.

### *Contributions from PPL*

From time to time PPL may make capital contributions to PPL Electric. PPL Electric may use these contributions for general corporate purposes.

### Long-Term Debt and Equity Securities

PPL Electric currently does not plan to issue any debt or equity securities in 2010.

#### Forecasted Uses of Cash

In addition to expenditures required for normal operating activities, such as purchased power, payroll, and taxes, PPL Electric currently expects to incur future cash outflows for capital expenditures, various contractual obligations, payment of dividends on its common and preferred securities and possibly the purchase or redemption of a portion of its debt securities.

#### Capital Expenditures

The table below shows PPL Electric's actual spending for the year 2009 and current capital expenditure projections for the years 2010 through 2012.

	<u>Actual</u>	<u>Projected</u>		
	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
Construction expenditures (a) (b)				
Transmission and distribution facilities	\$ 264	\$ 542	\$ 739	\$ 605
Other	34	47	38	39
Total Capital Expenditures	<u>\$ 298</u>	<u>\$ 589</u>	<u>\$ 777</u>	<u>\$ 644</u>

(a) Construction expenditures include AFUDC, which is expected to be approximately \$34 million for the years 2010 through 2012.

(b) Includes expenditures for intangible assets.

PPL Electric's capital expenditure projections for the years 2010 through 2012 total approximately \$2.0 billion. Capital expenditure plans are revised periodically to reflect changes in operational, market and regulatory conditions. The table includes projected costs for the asset optimization program focused on the replacement of aging transmission and distribution assets, and the PJM-approved regional transmission line expansion project. See Note 8 to the Financial Statements for additional information.

PPL Electric plans to fund its capital expenditures in 2010 with cash on hand and cash from operations.

#### Contractual Obligations

PPL Electric has assumed various financial obligations and commitments in the ordinary course of conducting its business. At December 31, 2009, the estimated contractual cash obligations of PPL Electric were:

	<u>Total</u>	<u>Less Than 1 Year</u>	<u>1-3 Years</u>	<u>4-5 Years</u>	<u>After 5 Years</u>
Long-term Debt (a)	\$ 1,474			\$ 410	\$ 1,064
Interest on Long-term Debt (b)	1,454	\$ 89	\$ 173	147	1,045
Purchase Obligations (c)	3,142	2,599	537	6	
Other Long-term Liabilities Reflected on the Balance Sheets under GAAP (d)					
Total Contractual Cash Obligations	<u>\$ 6,070</u>	<u>\$ 2,688</u>	<u>\$ 710</u>	<u>\$ 563</u>	<u>\$ 2,109</u>

(a) Reflects principal maturities only based on legal maturity dates. See Note 7 to the Financial Statements for a discussion of variable-rate remarketable bonds issued by the PEDFA on behalf of PPL Electric. PPL Electric does not have any capital or operating lease obligations.

(b) Assumes interest payments through maturity. The payments herein are subject to change, as payments for variable-rate debt have been estimated.

(c) The payments reflected herein are subject to change, as the purchase obligation reflected is an estimate based on projected obligated quantities and projected pricing under the contract. Purchase orders made in the ordinary course of business are excluded from the amounts presented.

(d) At December 31, 2009, total unrecognized tax benefits of \$74 million were excluded from this table as PPL Electric cannot reasonably estimate the amount and period of future payments. See Note 5 to the Financial Statements for additional information.

#### Dividends

From time to time, as determined by its Board of Directors, PPL Electric pays dividends on its common stock to its parent, PPL.

As discussed in Note 7 to the Financial Statements, PPL Electric may not pay dividends on its common stock, except in certain circumstances, unless full dividends have been paid on the 6.25% Series Preference Stock for the then-current dividend period. PPL Electric does not, at this time, expect that such limitation would significantly impact its ability to declare dividends.

PPL Electric expects to continue to pay quarterly dividends on its outstanding preferred securities, if and as declared by its Board of Directors.

### *Purchase or Redemption of Debt Securities*

PPL Electric will continue to evaluate purchasing or redeeming outstanding debt securities and may decide to take action depending upon prevailing market conditions and available cash.

### Credit Ratings

Moody's, S&P and Fitch periodically review the credit ratings on the debt and preferred securities of PPL Electric. Based on their respective independent reviews, the rating agencies may make certain ratings revisions or ratings affirmations.

A credit rating reflects an assessment by the rating agency of the creditworthiness associated with an issuer and particular securities that it issues. The credit ratings of PPL Electric are based on information provided by PPL Electric and other sources. The ratings of Moody's, S&P and Fitch are not a recommendation to buy, sell or hold any securities of PPL Electric. Such ratings may be subject to revisions or withdrawal by the agencies at any time and should be evaluated independently of each other and any other rating that may be assigned to the securities. A downgrade in PPL Electric's credit ratings could result in higher borrowing costs and reduced access to capital markets.

The following table summarizes the credit ratings of PPL Electric at December 31, 2009:

	<u>Moody's</u>	<u>S&amp;P</u>	<u>Fitch (a)</u>
<b>PPL Electric (b)</b>			
Senior Unsecured/Issuer Rating	Baa1	A-	BBB
First Mortgage Bonds/Senior Secured Bonds	A3	A-	A-
Commercial Paper	P-2	A-2	F2
Preferred Stock	Baa3	BBB	BBB
Preference Stock	Baa3	BBB	BBB
Outlook	Negative	Negative	STABLE

(a) Issuer Rating for Fitch is an "Issuer Default Rating."

(b) Excludes Pollution Control Revenue Bonds issued by the LCIDA and the PEDFA on behalf of PPL Electric, of which the LCIDA bonds are insured and may be rated on the basis of relevant factors, including the insurer's ratings.

In January 2009, S&P completed a review of PPL Electric, upon which it revised its outlook to negative from stable and affirmed the A- issuer rating of PPL Electric. S&P stated in its press release that the revision in its outlook reflects the linkage with PPL, whose outlook was also revised to negative from stable, along with their expectation that PPL Electric's financial metrics could weaken beginning in 2010.

In May 2009, Moody's completed a review of PPL Electric. As a result of that review, Moody's revised its outlook for PPL Electric to negative from stable. Moody's stated in its press release that the revision in the outlook for PPL Electric reflects Moody's expectation that PPL Electric's financial metrics will deteriorate beyond 2009 and considers the potential for additional pressure on cash flows.

In October 2009, Fitch completed a review of PPL Electric, upon which it affirmed all ratings of PPL Electric.

In January 2010, as a result of implementing its recently revised guidelines for rating preferred stock and hybrid securities, Fitch lowered the ratings of PPL Electric's preferred stock and preference stock to BBB- from BBB. Fitch stated in its press release that the new guidelines, which apply to instruments issued by companies in all sectors, typically resulted in downgrades of one notch for many instruments that provide for the ability to defer interest or dividend payments. Fitch stated that it has no reason to believe that deferral will be activated.

### **Off-Balance Sheet Arrangements**

PPL Electric has entered into certain agreements that may contingently require payment to a guaranteed or indemnified party. See Note 14 to the Financial Statements for a discussion of these agreements.

### **Risk Management**

#### Market Risk

##### *Commodity Price and Volumetric Risk - PLR Contracts*

PPL Electric has an obligation to act as a PLR. This role has the potential to expose PPL Electric to electric generation price and volumetric risk. Through 2009, PPL Electric and PPL EnergyPlus had power supply agreements under which PPL EnergyPlus sold PPL Electric (under a predetermined pricing arrangement) energy and capacity to fulfill this PLR obligation. As a result, PPL Electric had shifted these risks to PPL EnergyPlus. For its 2010 PLR obligation, PPL Electric has entered into power purchase agreements with several counterparties, which include fixed prices that shift these risks to the counterparties. PPL Electric is in the process of procuring such supply for the period January 2011 through May 2013. In the event a supplier defaults on its obligation, PPL Electric would be required to seek replacement power in the market. All incremental costs incurred by PPL Electric would be recoverable from customers in future rates. See "Overview" in this Item 7 and Note 14 to the Financial Statements for information on the PUC-approved procurement plan and other ongoing Pennsylvania regulatory and legislative activities.

### *Interest Rate Risk*

PPL Electric has issued debt to finance its operations, which exposes it to interest rate risk. PPL Electric's potential annual exposure to increased interest expense, based on a 10% increase in interest rates, was not significant at December 31, 2009 and 2008. PPL Electric estimated that a 10% decrease in interest rates at December 31, 2009 would increase the fair value of its debt portfolio by \$69 million, compared with \$50 million at December 31, 2008.

### Credit Risk

Credit risk is the risk that PPL Electric would incur a loss as a result of nonperformance by counterparties of their contractual obligations. PPL Electric requires that counterparties maintain specified credit ratings and requires other assurances in the form of credit support or collateral in certain circumstances in order to limit counterparty credit risk. However, PPL Electric has concentrations of suppliers, financial institutions and customers. These concentrations may impact PPL Electric's overall exposure to credit risk, positively or negatively, as counterparties may be similarly affected by changes in economic, regulatory or other conditions.

In 2007, the PUC approved PPL Electric's post-rate cap plan to procure default electricity supply for retail customers who do not choose an alternative competitive supplier in 2010. From 2007 through 2009, PPL Electric conducted six competitive solicitations to purchase electricity generation supply for these customers.

In October 2009, PPL Electric purchased 2010 supply for fixed-price default service to large commercial and large industrial customers who elect to take that service. In November 2009, PPL Electric purchased supply to provide hourly default service to large commercial and industrial customers in 2010.

In June 2009, the PUC approved PPL Electric's procurement plan for the period January 2011 through May 2013. The first two of 14 planned competitive solicitations occurred in 2009.

Under the standard Supply Master Agreement (the Agreement) for the bid solicitation process, PPL Electric requires all suppliers to post collateral if their credit exposure exceeds an established credit limit. In the event a supplier defaults on its obligation, PPL Electric would be required to seek replacement power in the market. All incremental costs incurred by PPL Electric would be recoverable from customers in future rates. At December 31, 2009, all of the successful bidders under all of the solicitations had an investment grade credit rating from S&P, and were not required to post collateral under the Agreement. There is no instance under the Agreement in which PPL Electric is required to post collateral to its suppliers.

See "Overview" in this Item 7 and Notes 14, 15, 17 and 18 to the Financial Statements for additional information on the competitive solicitations, the Agreement and credit concentration and risk.

### **Related Party Transactions**

PPL Electric is not aware of any material ownership interests or operating responsibility by senior management of PPL Electric in outside partnerships, including leasing transactions with variable interest entities, or other entities doing business with PPL Electric.

For additional information on related party transactions, see Note 15 to the Financial Statements.

### **Environmental Matters**

See "Item 1. Business - Environmental Matters" and Note 14 to the Financial Statements for a discussion of environmental matters.

### **Competition**

See "Item 1. Business - Segment Information - Pennsylvania Delivery Segment - Competition" and "Item 1A. Risk Factors" for a discussion of competitive factors affecting PPL Electric.

### **New Accounting Guidance**

See Notes 1 and 22 to the Financial Statements for a discussion of new accounting guidance adopted and pending adoption.

### **Application of Critical Accounting Policies**

PPL Electric's financial condition and results of operations are impacted by the methods, assumptions and estimates used in the application of critical accounting policies. The following accounting policies are particularly important to the financial condition or results of operations of PPL Electric, and require estimates or other judgments of matters inherently uncertain. Changes in the estimates or other judgments included within these accounting policies could result in a significant change to the information presented in the Financial Statements (these accounting policies are also discussed in Note 1 to the Financial Statements). PPL's senior management has reviewed these critical accounting policies and the estimates and assumptions regarding them with its Audit Committee. In addition, PPL's senior management has reviewed the following disclosures regarding the application of these critical accounting policies with the Audit Committee.

Effective January 1, 2009, PPL Electric fully applied accounting guidance that provides a framework for measuring fair value. The fair value measurement concepts provided by this guidance are used within its financial statements where applicable. See Notes 1 and 17 to the Financial

Statements for additional information regarding fair value measurements.

## 1) Defined Benefits

PPL Electric participates in and is allocated a significant portion of the liability and net periodic defined benefit pension and other postretirement costs of plans sponsored by PPL Services based on participation in those plans. PPL Electric records an asset or liability to recognize the funded status of all defined benefit plans with an offsetting entry to regulatory assets. Consequently, the funded status of all defined benefit plans is fully recognized on the Balance Sheets. See Note 12 to the Financial Statements for additional information about the plans and the accounting for defined benefits.

PPL makes certain assumptions regarding the valuation of benefit obligations and the performance of plan assets. When accounting for defined benefits, *delayed recognition in earnings of differences between actual results and expected or estimated results* is a guiding principle. Annual net periodic defined benefit costs are recorded in current earnings based on estimated results. Any differences between actual and estimated results are recorded in regulatory assets. The amount in regulatory assets is *amortized to income over future periods*. The delayed recognition allows for a smoothed recognition of costs over the working lives of the employees who benefit under the plans. The primary assumptions are:

- **Discount Rate** - The discount rate is used in calculating the present value of benefits, which is based on projections of benefit payments to be made in the future. The objective in selecting the discount rate is to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments, would provide the necessary future cash flows to pay the accumulated benefits when due.
- **Expected Return on Plan Assets** - Management projects the long-term rates of return on plan assets based on historical performance, future expectations and periodic portfolio rebalancing among the diversified asset classes. These projected returns reduce the net benefit costs PPL Electric records currently.
- **Rate of Compensation Increase** - Management projects employees' annual pay increases, which are used to project employees' pension benefits at retirement.
- **Health Care Cost Trend Rate** - Management projects the expected increases in the cost of health care.

In selecting a discount rate for its U.S. defined benefit plans, PPL starts with an analysis of the expected benefit payment stream for its plans. This information is first matched against a spot-rate yield curve. A portfolio of 526 Aa-graded non-callable (or callable with make-whole provisions) bonds, with a total amount outstanding in excess of \$541 billion, serves as the base from which those with the lowest and highest yields are eliminated to develop the ultimate yield curve. The results of this analysis are considered together with other economic data and movements in various bond indices to determine the discount rate assumption. At December 31, 2009, PPL decreased the discount rate for its U.S. pension plans from 6.50% to 6.00% as a result of this assessment and decreased the discount rate for its other postretirement benefit plans from 6.45% to 5.81%.

The expected long-term rates of return for PPL's U.S. defined benefit pension and other postretirement benefits have been developed using a best-estimate of expected returns, volatilities and correlations for each asset class. PPL management corroborates these rates with expected long-term rates of return calculated by its independent actuary, who uses a building block approach that begins with a risk-free rate of return with factors being added such as inflation, duration, credit spreads and equity risk. Each plan's specific asset allocation is also considered in developing a reasonable return assumption. At December 31, 2009, PPL's expected return on plan assets remained at 8.00% for its U.S. pension plans and remained at 7.00% for its other postretirement benefit plans.

In selecting a rate of compensation increase, PPL considers past experience in light of movements in inflation rates. At December 31, 2009, PPL's rate of compensation increase remained at 4.75% for its U.S. plans.

In selecting health care cost trend rates for PPL's other postretirement benefit plans, PPL considers past performance and forecasts of health care costs. At December 31, 2009, PPL's health care cost trend rates were 8.00% for 2010, gradually declining to 5.50% for 2016.

A variance in the assumptions listed above could have a significant impact on the accrued defined benefit liabilities or assets, reported annual net periodic defined benefit costs and the regulatory assets allocated to PPL Electric. While the charts below reflect either an increase or decrease in each assumption, the inverse of this change would impact the accrued defined benefit liabilities or assets, reported annual net periodic defined benefit costs and regulatory assets by a similar amount in the opposite direction. The sensitivities below reflect an evaluation of the change based solely on a change in that assumption and does not include income tax effects.

At December 31, 2009, PPL Electric had recorded the following defined benefit plan liabilities:

Pension liabilities	\$	245
Other postretirement benefit liabilities		73

The following chart reflects the sensitivities in the December 31, 2009 Balance Sheet associated with a change in certain assumptions based on PPL's primary defined benefit plans.

Actuarial assumption	Change in assumption	Increase (Decrease)	
		Impact on defined benefit liabilities	Impact on regulatory assets



Discount Rate	(0.25)%	\$	31	\$	31
Rate of Compensation Increase	0.25%		5		5
Health Care Cost Trend Rate (a)	1.0%		5		5

4) Only impacts other postretirement benefits.

In 2009, PPL Electric was allocated net periodic defined benefit costs charged to operating expense of \$24 million. This amount represents a \$6 million increase compared with the charge recognized during 2008.

The following chart reflects the sensitivities in the 2009 Statement of Income (excluding income tax effects) associated with a change in certain assumptions based on PPL's primary defined benefit plans.

<u>Actuarial assumption</u>	<u>Change in assumption</u>		<u>Impact on defined benefit costs</u>
Discount Rate	(0.25)%	\$	1
Expected Return on Plan Assets	(0.25)%		2
Rate of Compensation Increase	0.25%		1
Health Care Cost Trend Rate (a)	1.0%		1

(a) Only impacts other postretirement benefits.

## 2) Loss Accruals

PPL Electric accrues losses for the estimated impacts of various conditions, situations or circumstances involving uncertain or contingent future outcomes. For loss contingencies, the loss must be accrued if (1) information is available that indicates it is probable that a loss has been incurred, given the likelihood of the uncertain future events, and (2) the amount of the loss can be reasonably estimated. Accounting guidance defines "probable" as cases in which "the future event or events are likely to occur." PPL Electric does not record the accrual of contingencies that might result in gains, unless recovery is assured. PPL Electric continuously assesses potential loss contingencies for environmental remediation, litigation claims, regulatory penalties and other events.

The accounting aspects of estimated loss accruals include (1) the initial identification and recording of the loss, (2) the determination of triggering events for reducing a recorded loss accrual, and (3) the ongoing assessment as to whether a recorded loss accrual is sufficient. All three of these aspects require significant judgment by PPL Electric's management. PPL Electric uses its internal expertise and outside experts (such as lawyers and engineers), as necessary, to help estimate the probability that a loss has been incurred and the amount (or range) of the loss.

No new significant loss accruals were recorded in 2009.

PPL Electric has identified certain other events that could give rise to a loss, but that do not meet the conditions for accrual. Such events are disclosed, but not recorded, when it is "reasonably possible" that a loss has been incurred. See Note 14 to the Financial Statements for disclosure of other potential loss contingencies that have not met the criteria for accrual.

When an estimated loss is accrued, PPL Electric identifies, where applicable, the triggering events for subsequently reducing the loss accrual. The triggering events generally occur when the contingency has been resolved and the actual loss is incurred, or when the risk of loss has diminished or been eliminated. The following are some of the triggering events that provide for the reduction of certain recorded loss accruals:

- Allowances for uncollectible accounts are reduced when accounts are written off after prescribed collection procedures have been exhausted, a better estimate of the allowance is determined or underlying amounts are ultimately collected.
- Environmental and other litigation contingencies are reduced when the contingency is resolved and PPL Electric makes actual payments, a better estimate of the loss is determined or the loss is no longer considered probable.

PPL Electric reviews its loss accruals on a regular basis to assure that the recorded potential loss exposures are appropriate. This involves ongoing communication and analyses with internal and external legal counsel, engineers, operation management and other parties.

## 3) Income Tax Uncertainties

Significant management judgment is required in developing PPL Electric's provision for income taxes primarily due to the uncertainty related to tax positions taken or expected to be taken in tax returns and the determination of deferred tax assets, liabilities and valuation allowances.

Significant management judgment is required to determine the amount of benefit recognized related to an uncertain tax position. PPL Electric evaluates its tax positions following a two-step process. The first step requires an entity to determine whether, based on the technical merits supporting a particular tax position, it is more likely than not (greater than a 50% chance) that the tax position will be sustained. This determination assumes that the relevant taxing authority will examine the tax position and is aware of all the relevant facts surrounding the tax position. The second step requires an entity to recognize in the financial statements the benefit of a tax position that meets the more-likely-

than-not recognition criterion. The benefit recognized is measured at the largest amount of benefit that has a likelihood of realization, upon settlement, that exceeds 50%. PPL Electric's management considers a number of factors in assessing the benefit to be recognized, including negotiation of a settlement.

On a quarterly basis, PPL Electric reassesses its uncertain tax positions by considering information known at the reporting date. Based on management's assessment of new information, PPL Electric may subsequently recognize a tax benefit for a previously unrecognized tax position, de-recognize a previously recognized tax position, or re-measure the benefit of a previously recognized tax position. The amounts ultimately paid upon resolution of issues raised by taxing authorities may differ materially from the amounts accrued and may materially impact PPL Electric's financial statements in the future.

The balance sheet classification of unrecognized tax benefits and the need for valuation allowances to reduce deferred tax assets also require significant management judgment. PPL Electric classifies unrecognized tax benefits as current, to the extent management expects to settle an uncertain tax position, by payment or receipt of cash, within one year of the reporting date. Valuation allowances are initially recorded and reevaluated each reporting period by assessing the likelihood of the ultimate realization of a deferred tax asset. Management considers a number of factors in assessing the realization of a deferred tax asset, including the reversal of temporary differences, future taxable income and ongoing prudent and feasible tax planning strategies. Any tax planning strategy utilized in this assessment must meet the recognition and measurement criteria utilized by PPL Electric to account for an uncertain tax positions. See Note 5 to the Financial Statements for the required disclosures.

At December 31, 2009, it was reasonably possible that during the next 12 months the total amount of unrecognized tax benefits could increase by as much as \$23 million or decrease by up to \$22 million for PPL Electric. This change could result from the timing and/or valuation of certain deductions, intercompany transactions and unitary filing groups. The events that could cause these changes are direct settlements with taxing authorities, litigation, legal or administrative guidance by relevant taxing authorities and the lapse of an applicable statute of limitation.

#### **4) Regulatory Assets**

PPL Electric's electricity delivery business is subject to cost-based rate-regulation. As a result, PPL Electric is required to reflect the effects of regulatory actions in its financial statements. PPL Electric records assets that result from the regulated ratemaking process that may not be recorded under GAAP for non-regulated entities. Regulatory assets generally represent incurred costs that have been deferred because such costs are probable of future recovery in regulated customer rates.

Management continually assesses whether the regulatory assets are probable of future recovery by considering factors such as changes in the applicable regulatory and political environments, the ability to recover costs through regulated rates, recent rate orders to other regulated entities, and the status of any pending or potential deregulation legislation. Based on this continual assessment, management believes the existing regulatory assets are probable of recovery. This assessment reflects the current political and regulatory climate at the state and federal levels, and is subject to change in the future. If future recovery of costs ceases to be probable, then asset write-offs would be required to be recognized in operating income. Additionally, the regulatory agencies can provide flexibility in the manner and timing of the depreciation of PP&E and amortization of regulatory assets.

At December 31, 2009 and 2008, PPL Electric had regulatory assets of \$531 million and \$763 million. All of PPL Electric's regulatory assets are either currently being recovered under specific rate orders or represent amounts that will be recovered in future rates based upon established regulatory practices.

#### **Other Information**

PPL's Audit Committee has approved the independent auditor to provide audit and audit-related services and other services permitted by Sarbanes-Oxley and SEC rules. The audit and audit-related services include services in connection with statutory and regulatory filings, reviews of offering documents and registration statements, and internal control reviews.

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**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

**PPL Corporation, PPL Energy Supply, LLC and PPL Electric Utilities Corporation**

Reference is made to "Risk Management - Energy Marketing & Trading and Other" for PPL and PPL Energy Supply and "Risk Management" for PPL Electric in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations."

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareowners of PPL Corporation

We have audited the accompanying consolidated balance sheets of PPL Corporation and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of income, equity, comprehensive income, and cash flows for each of the three years in the period ended December 31, 2009. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of PPL Corporation and subsidiaries at December 31, 2009 and 2008, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2009, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), PPL Corporation's internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 25, 2010 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania  
February 25, 2010

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareowners of PPL Corporation

We have audited PPL Corporation's internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). PPL Corporation's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in Management's Report on Internal Control over Financial Reporting at Item 9A. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, PPL Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of PPL Corporation and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of income, equity, comprehensive income, and cash flows for each of the three years in the period ended December 31, 2009 and our report dated February 25, 2010 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania  
February 25, 2010

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**Report of Independent Registered Public Accounting Firm**

To the Board of Managers and Sole Member of PPL Energy Supply, LLC

We have audited the accompanying consolidated balance sheets of PPL Energy Supply, LLC and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of income, equity, comprehensive income, and cash flows for each of the three years in the period ended December 31, 2009. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of PPL Energy Supply, LLC and subsidiaries at December 31, 2009 and 2008, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2009, in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania  
February 25, 2010

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareowner of PPL Electric Utilities Corporation

We have audited the accompanying consolidated balance sheets of PPL Electric Utilities Corporation and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of income, shareowners' equity, and cash flows for each of the three years in the period ended December 31, 2009. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of PPL Electric Utilities Corporation and subsidiaries at December 31, 2009 and 2008, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2009, in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania  
February 25, 2010

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**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

**CONSOLIDATED STATEMENTS OF INCOME FOR THE YEARS ENDED DECEMBER 31,**

**PPL Corporation and Subsidiaries**

*Millions of Dollars, except share data*

	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>Operating Revenues</b>			
Utility	\$ 3,902	\$ 4,114	\$ 4,114
Unregulated retail electric and gas	152	151	102
Wholesale energy marketing			
Realized	3,291	2,288	1,581
Unrealized economic activity (Note 18)	(229)	1,056	(145)
Net energy trading margins	17	(121)	41
Energy-related businesses	423	519	769
<b>Total Operating Revenues</b>	<u>7,556</u>	<u>8,007</u>	<u>6,462</u>
<b>Operating Expenses</b>			
Operation			
Fuel	931	1,084	890
Energy purchases			
Realized	2,636	1,634	918
Unrealized economic activity (Note 18)	155	553	(182)
Other operation and maintenance	1,424	1,423	1,365
Amortization of recoverable transition costs	304	293	310
Depreciation (Note 1)	469	458	442
Taxes, other than income (Note 5)	280	288	298
Energy-related businesses (Note 8)	396	481	762
<b>Total Operating Expenses</b>	<u>6,595</u>	<u>6,214</u>	<u>4,803</u>
<b>Operating Income</b>	<b>961</b>	<b>1,793</b>	<b>1,659</b>
Other Income - net (Note 16)	49	55	97
Other-Than-Temporary Impairments	18	36	3
Interest Expense	396	455	472
<b>Income from Continuing Operations Before Income Taxes</b>	<b>596</b>	<b>1,357</b>	<b>1,281</b>
Income Taxes (Note 5)	130	430	259
<b>Income from Continuing Operations After Income Taxes</b>	<b>466</b>	<b>927</b>	<b>1,022</b>
Income (Loss) from Discontinued Operations (net of income taxes) (Note 9)	(40)	23	293
<b>Net Income</b>	<b>426</b>	<b>950</b>	<b>1,315</b>
Net Income Attributable to Noncontrolling Interests	19	20	27
<b>Net Income Attributable to PPL Corporation</b>	<u><u>\$ 407</u></u>	<u><u>\$ 930</u></u>	<u><u>\$ 1,288</u></u>
<b>Amounts Attributable to PPL Corporation:</b>			
Income from Continuing Operations After Income Taxes	\$ 447	\$ 907	\$ 1,001
Income (Loss) from Discontinued Operations (net of income taxes)	(40)	23	287
<b>Net Income</b>	<u><u>\$ 407</u></u>	<u><u>\$ 930</u></u>	<u><u>\$ 1,288</u></u>
<b>Earnings Per Share of Common Stock:</b>			
Income from Continuing Operations After Income Taxes Available to PPL Corporation Common Shareowners:			
Basic	\$ 1.18	\$ 2.42	\$ 2.62
Diluted	\$ 1.18	\$ 2.41	\$ 2.60
Net Income Available to PPL Corporation Common Shareowners:			
Basic	\$ 1.08	\$ 2.48	\$ 3.37
Diluted	\$ 1.08	\$ 2.47	\$ 3.34
<b>Dividends Declared Per Share of Common Stock</b>	<b>\$ 1.38</b>	<b>\$ 1.34</b>	<b>\$ 1.22</b>

**Weighted-Average Shares of Common Stock Outstanding** *(in thousands)*

Basic	<b>376,082</b>	373,626	380,563
Diluted	<b>376,406</b>	374,901	383,492

*The accompanying Notes to Consolidated Financial Statements are an integral part of the financial statements.*

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**CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31,**  
**PPL Corporation and Subsidiaries**  
*(Millions of Dollars)*

	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>Cash Flows from Operating Activities</b>			
Net income	\$ 426	\$ 950	\$ 1,315
Adjustments to reconcile net income to net cash provided by operating activities			
Pre-tax gain from the sale of the Latin American businesses			(400)
Pre-tax gain from the sale of the majority of Maine hydroelectric generation business	(38)		
Depreciation	471	461	458
Amortization of recoverable transition costs and other	389	383	433
Defined benefits	(115)	(100)	(39)
Impairment of assets	127	105	124
Gain on the sale of emission allowances	(2)	(6)	(109)
Deferred income taxes and investment tax credits	104	43	42
Unrealized (gains) losses on derivatives, and other hedging activities	329	(279)	(22)
Other	23	71	38
Change in current assets and current liabilities			
Accounts receivable	76	118	(186)
Accounts payable	(150)	85	119
Unbilled revenues	2	(85)	(99)
Fuel, materials and supplies	(21)	(35)	25
Counterparty collateral	334	1	12
Price risk management assets and liabilities	(231)	(77)	(45)
Other	96	(16)	(4)
Other operating activities			
Other assets	12	21	(12)
Other liabilities	20	(51)	(79)
	<u>1,852</u>	<u>1,589</u>	<u>1,571</u>
Net cash provided by operating activities			
<b>Cash Flows from Investing Activities</b>			
Expenditures for property, plant and equipment	(1,225)	(1,418)	(1,657)
Proceeds from the sale of the majority of Maine hydroelectric generation business	81		
Proceeds from the sale of the gas and propane businesses		303	
Proceeds from the sale of the Latin American businesses			851
Proceeds from the sale of the telecommunication operations			47
Expenditures for intangible assets	(88)	(332)	(65)
Proceeds from the sale of intangible assets	16	19	111
Purchases of nuclear plant decommissioning trust investments	(227)	(224)	(190)
Proceeds from the sale of nuclear plant decommissioning trust investments	201	197	175
Purchases of other investments		(290)	(601)
Proceeds from the sale of other investments	154	195	860
Net (increase) decrease in restricted cash and cash equivalents	218	(71)	(125)
Other investing activities	(10)	(6)	(20)
	<u>(880)</u>	<u>(1,627)</u>	<u>(614)</u>
Net cash used in investing activities			
<b>Cash Flows from Financing Activities</b>			
Issuance of long-term debt	298	1,338	985
Retirement of long-term debt	(1,016)	(671)	(1,216)
Repurchase of common stock		(38)	(712)
Issuance of common stock	60	19	32
Payment of common stock dividends	(517)	(491)	(459)
Net increase (decrease) in short-term debt	(52)	588	61
Other financing activities	(44)	(24)	(17)
	<u>(1,271)</u>	<u>721</u>	<u>(1,326)</u>
Net cash provided by (used in) financing activities			
<b>Effect of Exchange Rates on Cash and Cash Equivalents</b>		(13)	5
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<u>(299)</u>	<u>670</u>	<u>(364)</u>
Cash and Cash Equivalents at Beginning of Period	<u>1,100</u>	<u>430</u>	<u>794</u>
Cash and Cash Equivalents at End of Period	<u>\$ 801</u>	<u>\$ 1,100</u>	<u>\$ 430</u>

**Supplemental Disclosures of Cash Flow Information**

Cash paid during the period for:

Interest - net of amount capitalized	\$	460	\$	423	\$	389
Income taxes - net	\$	16	\$	300	\$	376

*The accompanying Notes to Consolidated Financial Statements are an integral part of the financial statements.*

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**CONSOLIDATED BALANCE SHEETS AT DECEMBER 31,**  
**PPL Corporation and Subsidiaries**  
*(Millions of Dollars, shares in thousands)*

	<u>2009</u>	<u>2008</u>
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 801	\$ 1,100
Short-term investments		150
Restricted cash and cash equivalents	105	320
Accounts receivable (less reserve: 2009, \$37; 2008, \$36)		
Customer	409	456
Other	59	77
Unbilled revenues	600	599
Fuel, materials and supplies (Note 1)	357	337
Prepayments	102	84
Price risk management assets (Notes 17 and 18)	2,157	1,224
Other intangibles (Note 19)	25	17
Assets held for sale (Note 9)	127	
Other current assets	10	19
<b>Total Current Assets</b>	<u>4,752</u>	<u>4,383</u>
<b>Investments</b>		
Nuclear plant decommissioning trust funds (Notes 17 and 21)	548	446
Other investments	65	76
<b>Total Investments</b>	<u>613</u>	<u>522</u>
<b>Property, Plant and Equipment (Note 1)</b>		
Electric plant		
Transmission and distribution	8,686	8,046
Generation	10,493	9,588
General	899	840
Electric plant in service	20,078	18,474
Construction work in progress	567	1,131
Nuclear fuel	506	428
Electric plant	21,151	20,033
Gas and oil plant	68	68
Other property	166	156
Property, plant and equipment, gross	21,385	20,257
Less: accumulated depreciation	8,211	7,882
<b>Property, Plant and Equipment, net</b>	<u>13,174</u>	<u>12,375</u>
<b>Regulatory and Other Noncurrent Assets</b>		
Regulatory assets (Note 1)	531	763
Goodwill (Note 19)	806	763
Other intangibles (Note 19)	615	637
Price risk management assets (Notes 17 and 18)	1,274	1,392
Other noncurrent assets	400	570
<b>Total Regulatory and Other Noncurrent Assets</b>	<u>3,626</u>	<u>4,125</u>
<b>Total Assets</b>	<u>\$ 22,165</u>	<u>\$ 21,405</u>

*The accompanying Notes to Consolidated Financial Statements are an integral part of the financial statements.*

**CONSOLIDATED BALANCE SHEETS AT DECEMBER 31,**  
**PPL Corporation and Subsidiaries**  
*(Millions of Dollars, shares in thousands)*

	<u>2009</u>	<u>2008</u>
<b>Liabilities and Equity</b>		
<b>Current Liabilities</b>		
Short-term debt (Note 7)	\$ 639	\$ 679
Long-term debt		696
Accounts payable	619	766
Taxes	92	77
Interest	113	130
Dividends	135	131
Price risk management liabilities (Notes 17 and 18)	1,502	1,324
Counterparty collateral	356	22
Other current liabilities	726	499
Total Current Liabilities	<u>4,182</u>	<u>4,324</u>
<b>Long-term Debt (Note 7)</b>	<u>7,143</u>	<u>7,142</u>
<b>Deferred Credits and Other Noncurrent Liabilities</b>		
Deferred income taxes and investment tax credits (Note 5)	2,153	1,761
Price risk management liabilities (Notes 17 and 18)	582	836
Accrued pension obligations (Note 12)	1,283	899
Asset retirement obligations (Note 20)	416	370
Other deferred credits and noncurrent liabilities	591	677
Total Deferred Credits and Other Noncurrent Liabilities	<u>5,025</u>	<u>4,543</u>
<b>Commitments and Contingent Liabilities (Note 14)</b>		
<b>Equity</b>		
PPL Corporation Shareowners' Common Equity		
Common stock - \$0.01 par value (a)	4	4
Capital in excess of par value	2,280	2,196
Earnings reinvested	3,749	3,862
Accumulated other comprehensive loss (Note 1)	(537)	(985)
Total PPL Corporation Shareowners' Common Equity	<u>5,496</u>	<u>5,077</u>
Noncontrolling Interests (Notes 3 and 6)	319	319
Total Equity	<u>5,815</u>	<u>5,396</u>
<b>Total Liabilities and Equity</b>	<u>\$ 22,165</u>	<u>\$ 21,405</u>

(a) 780,000 shares authorized; 377,183 shares and 374,581 shares issued and outstanding at December 31, 2009 and 2008.

*The accompanying Notes to Consolidated Financial Statements are an integral part of the financial statements.*

**CONSOLIDATED STATEMENTS OF EQUITY**  
**PPL Corporation and Subsidiaries**  
*(Millions of Dollars)*

	PPL Corporation Shareowners						
	Common stock shares outstanding (a)	Common stock	Capital in excess of par value	Earnings reinvested	Accumulated other comprehensive loss	Non- controlling interests	Total
<b>December 31, 2006 (b)</b>	385,039	\$ 4	\$ 2,823	\$ 2,613	\$ (318)	\$ 361	\$ 5,483
Common stock issued (c)	3,177		48				48
Common stock repurchased (d)	(14,945)		(712)				(712)
Stock-based compensation			26				26
Net income				1,288		27	1,315
Dividends, dividend equivalents and distributions (e)				(466)		(25)	(491)
Divestitures						(35)	(35)
Acquisitions						(8)	(8)
Other comprehensive income					250		250
<b>December 31, 2007</b>	<u>373,271</u>	<u>\$ 4</u>	<u>\$ 2,185</u>	<u>\$ 3,435</u>	<u>\$ (68)</u>	<u>\$ 320</u>	<u>\$ 5,876</u>
Common stock issued (c)	2,158		\$ 29				\$ 29
Common stock repurchased (d)	(848)		(38)				(38)
Stock-based compensation			20				20
Net income				\$ 930		\$ 20	950
Dividends, dividend equivalents and distributions (e)				(503)		(20)	(523)
Divestitures						(1)	(1)
Other comprehensive income					\$ (917)		(917)
<b>December 31, 2008 (f)</b>	<u>374,581</u>	<u>\$ 4</u>	<u>\$ 2,196</u>	<u>\$ 3,862</u>	<u>\$ (985)</u>	<u>\$ 319</u>	<u>\$ 5,396</u>
Common stock issued (c)	2,649		\$ 83				\$ 83
Common stock repurchased	(47)		(1)				(1)
Stock-based compensation			2				2
Net income				\$ 407		\$ 19	426
Dividends, dividend equivalents and distributions (e)				(521)		(19)	(540)
Other comprehensive income					\$ 449		449
Cumulative effect adjustment (g)				1	(1)		
<b>December 31, 2009 (f)</b>	<u>377,183</u>	<u>\$ 4</u>	<u>\$ 2,280</u>	<u>\$ 3,749</u>	<u>\$ (537)</u>	<u>\$ 319</u>	<u>\$ 5,815</u>

- (a) Shares in thousands. Each share entitles the holder to one vote on any question presented to any shareowners' meeting.
- (b) "Capital in excess of par value" and "Earnings reinvested" have been adjusted by \$13 million to reflect the adoption of new accounting guidance. See "New Accounting Guidance Adopted - Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)" in Note 1 for additional information.
- (c) 2009 includes common stock shares issued through the ICP, ICPKE, DRIP, ESOP and DDCP. 2008 and 2007 include common stock shares issued through the ICP, ICPKE, DDCP and the 2-5/8% Convertible Senior Notes, net of forfeitures. "Capital in excess of par value" for 2009 includes \$7 million for a company contribution to the ESOP.
- (d) In 2007, PPL's Board of Directors authorized the repurchase by PPL of up to \$750 million of its common stock. During 2007, PPL repurchased 14,929,892 shares of PPL common stock for \$712 million. During 2008, PPL repurchased 802,816 shares of PPL common stock for \$38 million.
- (e) "Earnings reinvested" includes dividends and dividend equivalents on PPL Corporation common stock and restricted stock units. "Noncontrolling interests" includes dividends and distributions to noncontrolling interests.
- (f) See "General - Comprehensive Income" in Note 1 for disclosure of balances of each component of AOCI.
- (g) See "New Accounting Guidance Adopted - Recognition and Presentation of Other-Than-Temporary Impairments" in Note 1 regarding this cumulative effect adjustment.

*The accompanying Notes to Consolidated Financial Statements are an integral part of the financial statements.*

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**FOR THE YEARS ENDED DECEMBER 31,**  
**PPL Corporation and Subsidiaries**  
*(Millions of Dollars)*

	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>Net income</b>	\$ 426	\$ 950	\$ 1,315
<b>Other comprehensive income (loss):</b>			
Amounts arising during the period - gains (losses), net of tax (expense) benefit:			
Foreign currency translation adjustments, net of tax of \$4, \$(11), \$7	101	(500)	29
Available-for-sale securities, net of tax of \$(44), \$55, \$(8)	41	(50)	11
Qualifying derivatives, net of tax of \$(356), \$(120), \$131	492	240	(190)
Equity investee's other comprehensive income (loss)	1	(3)	
Defined benefit plans:			
Prior service costs, net of tax of \$(1), \$0	1		2
Net actuarial gain (loss), net of tax of \$147, \$294, \$(104)	(340)	(577)	233
Reclassifications to net income - (gains) losses, net of tax expense (benefit):			
Foreign currency translation adjustments, net of tax of \$(8)			64
Available-for-sale securities, net of tax of \$(3), \$(2), \$2	4	2	(3)
Qualifying derivatives, net of tax of \$(92), \$17, \$(26)	131	(69)	49
Defined benefit plans:			
Prior service costs, net of tax of \$(8), \$(9), \$6	13	18	14
Net actuarial loss, net of tax of \$(4), \$(11), \$(19)	4	20	40
Transition obligation, net of tax of \$(1), \$(1), \$(1)	1	2	1
<b>Total other comprehensive income (loss) attributable to PPL Corporation</b>	<u>449</u>	<u>(917)</u>	<u>250</u>
<b>Comprehensive income</b>	<u>875</u>	<u>33</u>	<u>1,565</u>
Comprehensive income attributable to noncontrolling interests	19	20	27
<b>Comprehensive income attributable to PPL Corporation</b>	<u>\$ 856</u>	<u>\$ 13</u>	<u>\$ 1,538</u>

*The accompanying Notes to Consolidated Financial Statements are an integral part of the financial statements.*



**CONSOLIDATED STATEMENTS OF INCOME FOR THE YEARS ENDED DECEMBER 31,**  
**PPL Energy Supply, LLC and Subsidiaries**  
*(Millions of Dollars)*

	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>Operating Revenues</b>			
Wholesale energy marketing			
Realized	\$ 3,291	\$ 2,288	\$ 1,581
Unrealized economic activity (Note 18)	(229)	1,056	(145)
Wholesale energy marketing to affiliate (Note 15)	1,806	1,826	1,810
Utility	684	824	863
Unregulated retail electric and gas	152	151	102
Net energy trading margins	17	(121)	41
Energy-related businesses	411	511	760
<b>Total Operating Revenues</b>	<u>6,132</u>	<u>6,535</u>	<u>5,012</u>
<b>Operating Expenses</b>			
Operation			
Fuel	931	1,084	890
Energy purchases			
Realized	2,523	1,470	711
Unrealized economic activity (Note 18)	155	553	(182)
Energy purchases from affiliate (Note 15)	70	108	156
Other operation and maintenance	1,067	1,070	1,005
Depreciation (Note 1)	325	314	299
Taxes, other than income (Note 5)	86	86	98
Energy-related businesses (Note 8)	388	478	757
<b>Total Operating Expenses</b>	<u>5,545</u>	<u>5,163</u>	<u>3,734</u>
<b>Operating Income</b>	587	1,372	1,278
Other Income - net (Note 16)	35	48	80
Other-Than-Temporary Impairments	18	36	3
Interest Income from Affiliates (Note 15)	2	14	29
Interest Expense	272	313	289
<b>Income from Continuing Operations Before Income Taxes</b>	334	1,085	1,095
Income Taxes (Note 5)	47	335	206
<b>Income from Continuing Operations After Income Taxes</b>	287	750	889
Income (Loss) from Discontinued Operations (net of income taxes) (Note 9)	(40)	20	325
<b>Net Income</b>	247	770	1,214
Net Income Attributable to Noncontrolling Interests	1	2	9
<b>Net Income Attributable to PPL Energy Supply</b>	<u>\$ 246</u>	<u>\$ 768</u>	<u>\$ 1,205</u>
<b>Amounts Attributable to PPL Energy Supply:</b>			
Income from Continuing Operations After Income Taxes	\$ 286	\$ 748	\$ 886
Income (Loss) from Discontinued Operations (net of income taxes)	(40)	20	319
<b>Net Income</b>	<u>\$ 246</u>	<u>\$ 768</u>	<u>\$ 1,205</u>

*The accompanying Notes to Consolidated Financial Statements are an integral part of the financial statements.*

**CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31,**  
**PPL Energy Supply, LLC and Subsidiaries**  
*(Millions of Dollars)*

	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>Cash Flows from Operating Activities</b>			
Net income	\$ 247	\$ 770	\$ 1,214
Adjustments to reconcile net income to net cash provided by operating activities			
Pre-tax gain from the sale of the Latin American businesses			(400)
Pre-tax gain from the sale of the majority of Maine hydroelectric generation business	(38)		
Depreciation	327	317	309
Amortization of energy commitments and other	75	66	104
Defined benefits	(113)	(97)	(34)
Impairment of assets	123	93	102
Gain on the sale of emission allowances	(2)	(6)	(109)
Deferred income taxes and investment tax credits	141	165	112
Unrealized (gains) losses on derivatives, and other hedging activities	330	(285)	(27)
Other	24	69	39
Change in current assets and current liabilities			
Accounts receivable	77	141	(217)
Accounts payable	(178)	72	104
Collateral on PLR energy supply from affiliate	300		
Unbilled revenues	9	(89)	(69)
Fuels, materials and supplies	(25)	(26)	29
Counterparty collateral	334	1	12
Price risk management assets and liabilities	(223)	(88)	(50)
Other	16	(21)	67
Other operating activities			
Other assets	15	15	(6)
Other liabilities	(26)	(58)	(86)
	<u>1,413</u>	<u>1,039</u>	<u>1,094</u>
Net cash provided by operating activities			
<b>Cash Flows from Investing Activities</b>			
Expenditures for property, plant and equipment	(907)	(1,114)	(1,331)
Proceeds from the sale of the majority of Maine hydroelectric generation business	81		
Proceeds from the sale of the Latin American businesses			851
Proceeds from the sale of the telecommunication operations			47
Expenditures for intangible assets	(78)	(325)	(65)
Proceeds from the sale of intangible assets	16	19	111
Purchases of nuclear plant decommissioning trust investments	(227)	(224)	(190)
Proceeds from the sale of nuclear plant decommissioning trust investments	201	197	175
Purchases of other investments		(197)	(561)
Proceeds from the sale of other investments	154	102	795
Net (increase) decrease in restricted cash and cash equivalents	219	(152)	(110)
Other investing activities	(10)	(2)	(27)
	<u>(551)</u>	<u>(1,696)</u>	<u>(305)</u>
Net cash used in investing activities			
<b>Cash Flows from Financing Activities</b>			
Issuance of long-term debt		849	136
Retirement of long-term debt	(220)	(266)	(378)
Contributions from Member	50	421	700
Distributions to Member	(943)	(750)	(1,471)
Net increase in short-term debt	43	534	62
Other financing activities	(11)	(9)	(12)
	<u>(1,081)</u>	<u>779</u>	<u>(963)</u>
Net cash provided by (used in) financing activities			
<b>Effect of Exchange Rates on Cash and Cash Equivalents</b>		<u>(13)</u>	<u>5</u>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<u>(219)</u>	<u>109</u>	<u>(169)</u>
Cash and Cash Equivalents at Beginning of Period	464	355	524
Cash and Cash Equivalents at End of Period	<u>\$ 245</u>	<u>\$ 464</u>	<u>\$ 355</u>

**Supplemental Disclosures of Cash Flow Information**

Cash paid (received) during the period for:

Interest - net of amount capitalized	\$	274	\$	271	\$	228
Income taxes - net	\$	(91)	\$	149	\$	196

*The accompanying Notes to Consolidated Financial Statements are an integral part of the financial statements.*

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**CONSOLIDATED BALANCE SHEETS AT DECEMBER 31,**  
**PPL Energy Supply, LLC and Subsidiaries**  
*(Millions of Dollars)*

	<u>2009</u>	<u>2008</u>
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 245	\$ 464
Short-term investments		150
Restricted cash and cash equivalents	99	315
Accounts receivable (less reserve: 2009, \$21; 2008, \$21)		
Customer	168	220
Other	31	66
Unbilled revenues	402	408
Accounts receivable from affiliates	165	159
Collateral on PLR energy supply to affiliate (Note 15)		300
Fuel, materials and supplies (Note 1)	325	301
Prepayments	56	71
Price risk management assets (Notes 17 and 18)	2,147	1,221
Other intangibles (Note 19)	25	17
Assets held for sale (Note 9)	127	
Other current assets	1	6
<b>Total Current Assets</b>	<u>3,791</u>	<u>3,698</u>
<b>Investments</b>		
Nuclear plant decommissioning trust funds (Notes 17 and 21)	548	446
Other investments	58	68
<b>Total Investments</b>	<u>606</u>	<u>514</u>
<b>Property, Plant and Equipment (Note 1)</b>		
Electric plant		
Transmission and distribution	4,024	3,540
Generation	10,493	9,588
General	285	286
Electric plant in service	14,802	13,414
Construction work in progress	422	1,031
Nuclear fuel	506	428
Electric plant	15,730	14,873
Gas and oil plant	68	68
Other property	164	154
Property, plant and equipment, gross	15,962	15,095
Less: accumulated depreciation	6,169	5,935
<b>Property, Plant and Equipment, net</b>	<u>9,793</u>	<u>9,160</u>
<b>Other Noncurrent Assets</b>		
Goodwill (Note 19)	806	763
Other intangibles (Note 19)	477	507
Price risk management assets (Notes 17 and 18)	1,234	1,346
Other noncurrent assets	317	481
<b>Total Other Noncurrent Assets</b>	<u>2,834</u>	<u>3,097</u>
<b>Total Assets</b>	<u>\$ 17,024</u>	<u>\$ 16,469</u>

*The accompanying Notes to Consolidated Financial Statements are an integral part of the financial statements.*

**CONSOLIDATED BALANCE SHEETS AT DECEMBER 31,**  
**PPL Energy Supply, LLC and Subsidiaries**  
*(Millions of Dollars)*

	<u>2009</u>	<u>2008</u>
<b>Liabilities and Equity</b>		
<b>Current Liabilities</b>		
Short-term debt (Note 7)	\$ 639	\$ 584
Accounts payable	537	684
Accounts payable to affiliates	51	62
Taxes	33	31
Interest	86	88
Deferred revenue on PLR energy supply to affiliate		12
Price risk management liabilities (Notes 17 and 18)	1,502	1,313
Counterparty collateral	356	22
Other current liabilities	481	371
Total Current Liabilities	<u>3,685</u>	<u>3,167</u>
<b>Long-term Debt (Note 7)</b>	<u>5,031</u>	<u>5,196</u>
<b>Deferred Credits and Other Noncurrent Liabilities</b>		
Deferred income taxes and investment tax credits (Note 5)	1,511	1,118
Price risk management liabilities (Notes 17 and 18)	582	836
Accrued pension obligations (Note 12)	883	556
Asset retirement obligations (Note 20)	416	370
Other deferred credits and noncurrent liabilities	330	414
Total Deferred Credits and Other Noncurrent Liabilities	<u>3,722</u>	<u>3,294</u>
<b>Commitments and Contingent Liabilities (Note 14)</b>		
<b>Equity</b>		
Member's equity	4,568	4,794
Noncontrolling interests	18	18
Total Equity	<u>4,586</u>	<u>4,812</u>
<b>Total Liabilities and Equity</b>	<u>\$ 17,024</u>	<u>\$ 16,469</u>

*The accompanying Notes to Consolidated Financial Statements are an integral part of the financial statements.*

**CONSOLIDATED STATEMENTS OF EQUITY**  
**PPL Energy Supply, LLC and Subsidiaries**  
*(Millions of Dollars)*

	<u>Member's equity</u>	<u>Non- controlling interests</u>	<u>Total</u>
<b>December 31, 2006</b>	\$ 4,534	\$ 60	\$ 4,594
Net income	1,205	9	1,214
Other comprehensive income	240		240
Cumulative effect adjustment (a)	(1)		(1)
Contributions from member	700		700
Distributions	(1,471)	(7)	(1,478)
Divestitures		(35)	(35)
Acquisitions		(8)	(8)
Other	(2)		(2)
<b>December 31, 2007</b>	<u>\$ 5,205</u>	<u>\$ 19</u>	<u>\$ 5,224</u>
Net income	\$ 768	\$ 2	\$ 770
Other comprehensive loss	(850)		(850)
Contributions from member	421		421
Distributions	(750)	(2)	(752)
Divestitures		(1)	(1)
<b>December 31, 2008 (b)</b>	<u>\$ 4,794</u>	<u>\$ 18</u>	<u>\$ 4,812</u>
Net income	\$ 246	\$ 1	\$ 247
Other comprehensive income	421		421
Contributions from member	50		50
Distributions	(943)	(1)	(944)
<b>December 31, 2009 (b)</b>	<u>\$ 4,568</u>	<u>\$ 18</u>	<u>\$ 4,586</u>

(a) Relates to the adoption of accounting guidance regarding uncertain tax positions.

(b) See "General - Comprehensive Income" in Note 1 for disclosure of balances of each component of AOCI.

*The accompanying Notes to Consolidated Financial Statements are an integral part of the financial statements.*

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**FOR THE YEARS ENDED DECEMBER 31,**  
**PPL Energy Supply, LLC and Subsidiaries**  
*(Millions of Dollars)*

	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>Net income</b>	\$ 247	\$ 770	\$ 1,214
<b>Other comprehensive income (loss):</b>			
Amounts arising during the period - gains (losses), net of tax (expense) benefit:			
Foreign currency translation adjustments, net of tax of \$4, \$(11), \$7	101	(500)	29
Available-for-sale securities, net of tax of \$(44), \$55, \$(8)	41	(50)	11
Qualifying derivatives, net of tax of \$(330), \$(125), \$124	454	249	(182)
Equity investee's other comprehensive income (loss)	1	(3)	
Defined benefit plans:			
Prior service costs	1	(1)	2
Net actuarial gain (loss), net of tax of \$136, 243, \$(98)	(326)	(500)	222
Reclassifications to net income - (gains) losses, net of tax expense (benefit):			
Foreign currency translation adjustments, net of tax of \$(8)			64
Available-for-sale securities, net of tax of \$(3), \$(2), \$2	4	2	(3)
Qualifying derivatives, net of tax of \$(91), \$19, \$(22)	131	(73)	46
Defined benefit plans:			
Prior service costs, net of tax of \$(6), \$(5), \$3	9	12	10
Net actuarial loss, net of tax of \$(3), \$(5), \$(18)	4	12	40
Transition obligation, net of tax of \$(1), \$(1), \$(1)	1	2	1
<b>Total other comprehensive income (loss) attributable to PPL Energy Supply</b>	<u>421</u>	<u>(850)</u>	<u>240</u>
<b>Comprehensive income (loss)</b>	<b>668</b>	<b>(80)</b>	<b>1,454</b>
Comprehensive income attributable to noncontrolling interests	1	2	9
<b>Comprehensive income (loss) attributable to PPL Energy Supply</b>	<u>\$ 667</u>	<u>\$ (82)</u>	<u>\$ 1,445</u>

*The accompanying Notes to Consolidated Financial Statements are an integral part of the financial statements*

**CONSOLIDATED STATEMENTS OF INCOME FOR THE YEARS ENDED DECEMBER 31,**  
**PPL Electric Utilities Corporation and Subsidiaries**  
*(Millions of Dollars)*

	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>perating Revenues</b>			
Retail electric	\$ 3,222	\$ 3,293	\$ 3,254
Wholesale electric to affiliate (Note 15)	70	108	156
<b>Total Operating Revenues</b>	<u>3,292</u>	<u>3,401</u>	<u>3,410</u>
<b>Operating Expenses</b>			
Operation			
Energy purchases	114	163	206
Energy purchases from affiliate (Note 15)	1,806	1,826	1,810
Other operation and maintenance	417	410	402
Amortization of recoverable transition costs	304	293	310
Depreciation (Note 1)	128	131	132
Taxes, other than income (Note 5)	194	203	200
<b>Total Operating Expenses</b>	<u>2,963</u>	<u>3,026</u>	<u>3,060</u>
<b>Operating Income</b>	329	375	350
Other Income - net (Note 16)	6	5	12
Interest Income from Affiliate (Note 15)	4	9	19
Interest Expense	116	101	118
Interest Expense with Affiliate (Note 15)	2	10	17
<b>Income Before Income Taxes</b>	<u>221</u>	<u>278</u>	<u>246</u>
Income Taxes (Note 5)	79	102	83
<b>et Income</b>	<u>142</u>	<u>176</u>	<u>163</u>
Dividends on Preferred Securities (Notes 6 and 7)	18	18	18
<b>Income Available to PPL</b>	<u>\$ 124</u>	<u>\$ 158</u>	<u>\$ 145</u>

*The accompanying Notes to Consolidated Financial Statements are an integral part of the financial statements.*



**CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31,**  
**PPL Electric Utilities Corporation and Subsidiaries**  
*(Millions of Dollars)*

	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>Cash Flows from Operating Activities</b>			
Net income	\$ 142	\$ 176	\$ 163
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation	128	131	132
Amortization of recoverable transition costs and other	324	313	326
Deferred income taxes and investment tax credits	(22)	1	17
Other	(4)	3	5
Change in current assets and current liabilities			
Accounts receivable	1	(22)	(5)
Accounts payable	(9)	(1)	26
Prepayments	(17)	9	(13)
Collateral on PLR energy supply from affiliate	(300)		
Other	50	27	(84)
Other operating activities			
Other assets	(3)	23	19
Other liabilities	4	(12)	(18)
Net cash provided by operating activities	<u>294</u>	<u>648</u>	<u>568</u>
<b>Cash Flows from Investing Activities</b>			
Expenditures for property, plant and equipment	(288)	(268)	(286)
Expenditures for intangible assets	(10)	(7)	
Purchases of investments		(90)	(32)
Proceeds from the sale of investments		90	57
Net (increase) decrease in notes receivable from affiliate	300	(23)	23
Net (increase) decrease in restricted cash and cash equivalents	1	69	(8)
Other investing activities	3	3	7
Net cash provided by (used in) investing activities	<u>6</u>	<u>(226)</u>	<u>(239)</u>
<b>Cash Flows from Financing Activities</b>			
Issuance of long-term debt	298	489	250
Retirement of long-term debt	(595)	(395)	(555)
Contribution from PPL	400		
Payment of common stock dividends to PPL	(274)	(98)	(119)
Payment of dividends on preferred securities	(18)	(18)	(18)
Net increase (decrease) in short-term debt	(95)	54	(1)
Other financing activities	(14)	(4)	(3)
Net cash provided by (used in) financing activities	<u>(298)</u>	<u>28</u>	<u>(446)</u>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<u>2</u>	<u>450</u>	<u>(117)</u>
Cash and Cash Equivalents at Beginning of Period	<u>483</u>	<u>33</u>	<u>150</u>
Cash and Cash Equivalents at End of Period	<u>\$ 485</u>	<u>\$ 483</u>	<u>\$ 33</u>
<b>Supplemental Disclosures of Cash Flow Information</b>			
Cash paid during the period for:			
Interest - net of amount capitalized	\$ 116	\$ 88	\$ 110
Income taxes - net	\$ 106	\$ 59	\$ 87

*The accompanying Notes to Consolidated Financial Statements are an integral part of the financial statements.*

**CONSOLIDATED BALANCE SHEETS AT DECEMBER 31,**  
**PPL Electric Utilities Corporation and Subsidiaries**  
*(Millions of Dollars, shares in thousands)*

	<u>2009</u>	<u>2008</u>
<b>Assets</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 485	\$ 483
Restricted cash and cash equivalents	1	1
Accounts receivable (less reserve: 2009, \$16; 2008, \$14)		
Customer	240	233
Other	19	11
Unbilled revenues	198	190
Materials and supplies	33	37
Accounts receivable from affiliates	7	8
Note receivable from affiliate (Note 15)		300
Prepayments	24	7
Prepayment on PLR energy supply from affiliate		12
Other current assets	29	13
<b>Total Current Assets</b>	<u>1,036</u>	<u>1,295</u>
<b>Property, Plant and Equipment (Note 1)</b>		
Electric plant		
Transmission and distribution	4,662	4,506
General	535	489
Electric plant in service	5,197	4,995
Construction work in progress	118	79
Electric plant	5,315	5,074
Other property	2	2
Property, plant and equipment, gross	5,317	5,076
Less: accumulated depreciation	2,008	1,924
<b>Property, Plant and Equipment, net</b>	<u>3,309</u>	<u>3,152</u>
<b>Regulatory and Other Noncurrent Assets</b>		
Recoverable transition costs (Note 1)		281
Intangibles (Note 19)	139	130
Taxes recoverable through future rates (Note 1)	253	250
Recoverable costs of defined benefit plans (Note 1)	229	192
Other regulatory and noncurrent assets	126	116
<b>Total Regulatory and Other Noncurrent Assets</b>	<u>747</u>	<u>969</u>
<b>Total Assets</b>	<u>\$ 5,092</u>	<u>\$ 5,416</u>

*The accompanying Notes to Consolidated Financial Statements are an integral part of the financial statements.*

**CONSOLIDATED BALANCE SHEETS AT DECEMBER 31,**  
**PPL Electric Utilities Corporation and Subsidiaries**  
*(Millions of Dollars, shares in thousands)*

	<u>2009</u>	<u>2008</u>
<b>Liabilities and Equity</b>		
<b>Current Liabilities</b>		
Short-term debt (Note 7)		\$ 95
Long-term debt		495
Accounts payable	\$ 53	57
Accounts payable to affiliates	186	186
Taxes	61	65
Collateral on PLR energy supply from affiliate (Note 15)		300
Overcollected transmission costs	39	
Customer rate mitigation prepayments	36	5
Overcollected transition costs	33	
Other current liabilities	110	119
Total Current Liabilities	<u>518</u>	<u>1,322</u>
<b>Long-term Debt (Note 7)</b>	<u>1,472</u>	<u>1,274</u>
<b>Deferred Credits and Other Noncurrent Liabilities</b>		
Deferred income taxes and investment tax credits (Note 5)	769	767
Accrued pension obligations (Note 12)	245	209
Other deferred credits and noncurrent liabilities	192	198
Total Deferred Credits and Other Noncurrent Liabilities	<u>1,206</u>	<u>1,174</u>
<b>Commitments and Contingent Liabilities (Note 14)</b>		
<b>Shareowners' Equity</b>		
Preferred securities (Note 6)	301	301
Common stock - no par value (a)	364	364
Additional paid-in capital	824	424
Earnings reinvested	407	557
Total Shareowners' Equity	<u>1,896</u>	<u>1,646</u>
<b>Total Liabilities and Equity</b>	<u>\$ 5,092</u>	<u>\$ 5,416</u>

(a) 170,000 shares authorized; 66,368 shares issued and outstanding at December 31, 2009 and 2008.

*The accompanying Notes to Consolidated Financial Statements are an integral part of the financial statements.*

**CONSOLIDATED STATEMENTS OF SHAREOWNERS' EQUITY**

**PPL Electric Utilities Corporation and Subsidiaries**

(Millions of Dollars, shares in thousands)

	Common stock shares outstanding (a)	Preferred securities	Common stock	Additional paid-in capital	Earnings reinvested	Total
<b>December 31, 2006</b>	66,368	\$ 301	\$ 364	\$ 424	\$ 470	\$ 1,559
Net income (b)					163	163
Cumulative effect adjustment (c)					1	1
Cash dividends declared on preferred securities					(18)	(18)
Cash dividends declared on common stock					(119)	(119)
<b>December 31, 2007</b>	<u>66,368</u>	<u>\$ 301</u>	<u>\$ 364</u>	<u>\$ 424</u>	<u>\$ 497</u>	<u>\$ 1,586</u>
Net income (b)					\$ 176	\$ 176
Cash dividends declared on preferred securities					(18)	(18)
Cash dividends declared on common stock					(98)	(98)
<b>December 31, 2008</b>	<u>66,368</u>	<u>\$ 301</u>	<u>\$ 364</u>	<u>\$ 424</u>	<u>\$ 557</u>	<u>\$ 1,646</u>
Net income (b)					\$ 142	\$ 142
Capital contribution from PPL				\$ 400		400
Cash dividends declared on preferred securities					(18)	(18)
Cash dividends declared on common stock					(274)	(274)
<b>December 31, 2009</b>	<u>66,368</u>	<u>\$ 301</u>	<u>\$ 364</u>	<u>\$ 824</u>	<u>\$ 407</u>	<u>\$ 1,896</u>

(a) All common shares of PPL Electric stock are owned by PPL.

(b) PPL Electric's net income approximates comprehensive income.

(c) Relates to the adoption of accounting guidance regarding uncertain tax positions.

*The accompanying Notes to Consolidated Financial Statements are an integral part of the financial statements.*

## COMBINED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. Summary of Significant Accounting Policies

#### General

Terms and abbreviations are explained in the glossary. Dollars are in millions, except per share data, unless otherwise noted.

#### Business and Consolidation

*(PPL)*

PPL is an energy and utility holding company that, through its subsidiaries, is primarily engaged in the generation and marketing of electricity in the northeastern and western U.S. and in the delivery of electricity in Pennsylvania and the U.K. Headquartered in Allentown, PA, PPL's principal direct subsidiaries are PPL Energy Funding, PPL Electric, PPL Services and PPL Capital Funding.

*(PPL and PPL Energy Supply)*

PPL Energy Funding is the parent of PPL Energy Supply, which serves as the holding company for PPL's principal unregulated subsidiaries. PPL Energy Supply is the parent of PPL Generation, PPL EnergyPlus and PPL Global.

PPL Generation owns and operates a portfolio of domestic power generating assets. These power plants are primarily located in Pennsylvania, Montana, Illinois, Connecticut and New York and use well-diversified fuel sources including coal, uranium, natural gas, oil and water. PPL EnergyPlus sells electricity produced by PPL Generation subsidiaries, participates in wholesale market load-following auctions, and markets various energy commodities such as: capacity, transmission, FTRs, coal, natural gas, oil, uranium, emission allowances, RECs and other commodities in competitive wholesale and deregulated retail markets, primarily in the northeastern and western U.S.

In May 2009, PPL Generation signed a definitive agreement to sell its Long Island generation business and related tolling agreements. In the fourth quarter of 2009, PPL Maine completed the sales of the majority of its hydroelectric generation business and its 8.33% ownership interest in Wyman Unit 4.

See Note 9 for additional information on both the anticipated and completed sales.

PPL Global owns and operates WPD's electricity delivery businesses in the U.K. In 2007, PPL Global completed the sale of its Latin American businesses.

It is the policy of PPL and PPL Energy Supply to consolidate foreign subsidiaries on a one-month lag. Material intervening events, such as debt issuances and retirements, acquisitions or divestitures that occur in the lag period are recognized in the current Financial Statements. Events that are significant but not material are disclosed.

The consolidated financial statements of PPL and PPL Energy Supply include their share of undivided interests in jointly owned facilities, as well as their share of the related operating costs of those facilities. See Note 13 for additional information.

*(PPL and PPL Electric)*

PPL Electric is a rate-regulated subsidiary of PPL. PPL Electric's principal business is the transmission and distribution of electricity to serve retail customers in its franchised territory in eastern and central Pennsylvania and the supply of electricity to retail customers in that territory as a PLR.

*(PPL, PPL Energy Supply and PPL Electric)*

The consolidated financial statements of PPL, PPL Energy Supply and PPL Electric include each company's own accounts as well as the accounts of all entities in which the company has a controlling financial interest. Consolidation generally has been applied to subsidiaries in which PPL, PPL Energy Supply and PPL Electric have a majority voting interest. However, the voting interest approach is not effective in identifying controlling financial interests in entities that are not controllable through voting interests or in which the equity investors do not bear the residual economic risks. These types of entities are referred to as variable interest entities. PPL, PPL Energy Supply and PPL Electric consolidate a variable interest entity when they are determined to be the primary beneficiary of the entity. The primary beneficiary of a variable interest entity is the party that absorbs a majority of the entity's expected losses, receives a majority of its expected residual returns, or both, as a result of holding variable interests. See Note 3 for additional information regarding variable interest entities. Investments in entities in which a company has the ability to exercise significant influence but does not have a controlling financial interest are accounted for under the equity method. All other investments are carried at cost or fair value. All significant intercompany transactions have been eliminated. Any noncontrolling interests are reflected in the consolidated financial statements.

#### Regulation

*(PPL and PPL Electric)*

The cost-based rate-regulated utility operations of PPL and PPL Electric reflect the effects of regulatory actions in their financial

statements. The regulatory assets below are included in "Regulatory and Other Noncurrent Assets" on the Balance Sheets of PPL and PPL Electric at December 31 and are probable of future recovery in regulated customer rates.

	<u>2009</u>	<u>2008</u>
Recoverable transition costs (a)		\$ 281
Taxes recoverable through future rates	\$ 253	250
Recoverable costs of defined benefit plans	229	192
Unamortized loss on reacquired debt	33	26
Costs associated with severe ice storms - January 2005	9	11
Other	7	3
	<u>\$ 531</u>	<u>\$ 763</u>

(a) A return on these assets is included in regulated rates.

The recoverable transition costs are the result of the PUC Final Order, which allowed PPL Electric to begin amortizing its competitive transition (or stranded) costs of \$2.97 billion, over an 11-year transition period effective January 1, 1999. In August 1999, competitive transition costs of \$2.4 billion were converted to intangible transition costs when they were securitized by the issuance of transition bonds. The intangible transition costs were amortized over the life of the transition bonds, through December 2008, in accordance with an amortization schedule filed with the PUC. The assets of PPL Transition Bond Company, including the intangible transition property, were not available to creditors of PPL or PPL Electric. The remaining competitive transition costs were also amortized based on an amortization schedule previously filed with the PUC, adjusted for those competitive transition costs that were converted to intangible transition costs. These costs were fully amortized in 2009.

Taxes recoverable through future rates represent the portion of future income taxes that will be recovered through future rates based upon established regulatory practices. Accordingly, this regulatory asset is recognized when the offsetting deferred tax liability is recognized. For general-purpose financial reporting, this regulatory asset and the deferred tax liability are not offset; rather, each is displayed separately. Because this regulatory asset does not represent cash tax expenditures already incurred by PPL, this regulatory asset is not earning a current return. This regulatory asset is expected to be recovered over the period that the underlying book-tax timing differences reverse and the actual cash taxes are incurred.

Recoverable costs of defined benefit plans represent the portion of unrecognized transition obligation, prior service cost, and net actuarial loss that will be recovered through future rates based upon established regulatory practices. These regulatory assets are adjusted at least annually or whenever the funded status of PPL's defined benefit plans is remeasured. These regulatory assets for PPL and PPL Electric do not represent cash expenditures already incurred; consequently, these assets are not earning a current return.

	<u>2009</u>	<u>2008</u>
Transition obligation	\$ 10	\$ 10
Prior service cost	55	69
Net actuarial loss	164	113
Recoverable costs of defined benefit plans	<u>\$ 229</u>	<u>\$ 192</u>

Of these costs, \$15 million for PPL and PPL Electric are expected to be amortized into net periodic defined benefit costs in 2010. All costs will be amortized over the average service lives of plan participants.

Unamortized loss on reacquired debt represents losses on long-term debt reacquired or redeemed that have been deferred and will be amortized and recovered through 2029.

In December 2007, the PUC approved recovery of \$12 million of costs associated with severe ice storms that occurred in January 2005. Monthly amortization began in January 2008 and will continue through August 2015.

The remainder of the regulatory assets included in "Other" will be recovered through 2013.

PPL and PPL Electric had the following regulatory liabilities at December 31, 2009. No significant regulatory liabilities existed at December 31, 2008.

	<u>2009</u>
Overcollected transition costs	\$ 33
PURTA tax refund	10
	<u>\$ 43</u>

The overcollected transition costs will be refunded to customers in 2010 and are reflected on the Balance Sheet in "Other current liabilities" for PPL and in "Overcollected transition costs" for PPL Electric.

In December 2009, PPL Electric reached a settlement with the Pennsylvania Department of Revenue related to the appeal of its 1997 PURTA tax assessments that resulted in a \$10 million reduction in PURTA tax. The \$10 million is expected to be refunded to customers in 2011 and is reflected in "Other deferred credits and noncurrent liabilities" on PPL's and PPL Electric's Balance Sheet.

*PPL and PPL Energy Supply*)

WPD operates under distribution licenses granted and price controls set by Ofgem. The price control formula that governs WPD's allowed revenue is normally determined every five years. Ofgem completed a review in December 2009.

WPD is not subject to accounting for the effects of certain types of regulation as prescribed by GAAP.

Accounting Records (PPL and PPL Electric)

The system of accounts for PPL Electric is maintained in accordance with the Uniform System of Accounts prescribed by the FERC and adopted by the PUC.

Use of Estimates (PPL, PPL Energy Supply and PPL Electric)

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Loss Accruals (PPL, PPL Energy Supply and PPL Electric)

Potential losses are accrued when (1) information is available that indicates it is "probable" that a loss has been incurred, given the likelihood of the uncertain future events and (2) the amount of the loss can be reasonably estimated. Accounting guidance defines "probable" as cases in which "the future event or events are likely to occur." PPL and its subsidiaries continuously assess potential loss contingencies for environmental remediation, litigation claims, regulatory penalties and other events. PPL and its subsidiaries discount loss accruals for environmental remediation when appropriate.

PPL and its subsidiaries do not record the accrual of contingencies that might result in gains, unless recovery is assured.

Changes in Classification (PPL, PPL Energy Supply and PPL Electric)

The classification of certain amounts in the 2008 and 2007 financial statements have been changed to conform to the current presentation. The changes in classification did not affect "Net Income Attributable to PPL Corporation" or "PPL Corporation Shareowners' Common Equity," "Net Income Attributable to PPL Energy Supply" or PPL Energy Supply's "Member's equity" or "Income Available to PPL" or PPL Electric's "Shareowners' Equity".

The classification on the Statements of Cash Flows has not been changed for the classification of amounts to Discontinued Operations.

Comprehensive Income (PPL and PPL Energy Supply)

Comprehensive income, which includes net income and OCI, consists of changes in equity from transactions not related to shareowners. Comprehensive income is shown on PPL's and PPL Energy Supply's Statements of Comprehensive Income.

AOCI, which is presented on the Balance Sheets of PPL and included in Member's Equity on the Balance Sheets of PPL Energy Supply, consisted of these after-tax amounts at December 31.

	<u>2009</u>	<u>2008</u>
<b><u>PPL</u></b>		
Foreign currency translation adjustments	\$ (136)	\$ (237)
Unrealized gains on available-for-sale securities	62	18
Net unrealized gains (losses) on qualifying derivatives	602	(21)
Equity investee's AOCI	(2)	(3)
Defined benefit plans:		
Prior service cost	(61)	(75)
Actuarial loss	(993)	(657)
Transition obligation	(9)	(10)
	<u>\$ (537)</u>	<u>\$ (985)</u>
<b><u>PPL Energy Supply</u></b>		
Foreign currency translation adjustments	\$ (136)	\$ (237)
Unrealized gains on available-for-sale securities	62	18
Net unrealized gains (losses) on qualifying derivatives	573	(12)
Equity investee's AOCI	(2)	(3)
Defined benefit plans:		
Prior service cost	(44)	(54)

Actuarial loss	(930)	(608)
Transition obligation	(7)	(8)
	<u>\$ (484)</u>	<u>\$ (904)</u>

### Earnings Per Share (PPL)

EPS is computed using the two-class method, which is an earnings allocation method for computing EPS that treats a participating security as having rights to earnings that would otherwise have been available to common shareowners. Share-based payment awards that provide recipients a non-forfeitable right to dividends or dividend equivalents are considered participating securities.

Basic EPS is computed by dividing income available to PPL common shareowners by the weighted-average number of common shares outstanding during the period. Diluted EPS is computed by dividing income available to PPL common shareowners by the weighted-average number of shares outstanding that are increased for additional shares that would be outstanding if potentially dilutive non-participating securities were converted to common shares. In 2009, these securities consisted of stock options and performance units granted under the incentive compensation plans. In 2008, these securities consisted of stock options, performance units and PPL Energy Supply's 2-5/8% Convertible Senior Notes. In 2007, these securities consisted of stock options and PPL Energy Supply's 2-5/8% Convertible Senior Notes.

### Price Risk Management

*(PPL and PPL Energy Supply)*

PPL and PPL Energy Supply enter into energy and energy-related contracts to hedge the variability of expected cash flows associated with their generating units and marketing activities, as well as for trading purposes. PPL and PPL Energy Supply enter into interest rate derivative contracts to hedge their exposure to changes in the fair value of their debt instruments and to hedge their exposure to variability in expected cash flows associated with existing debt instruments or forecasted issuances of debt. PPL and PPL Energy Supply also enter into foreign currency derivative contracts to hedge foreign currency exposures related to firm commitments, recognized assets or liabilities, forecasted transactions, net investments and foreign earnings translation.

PPL and PPL Energy Supply have contracts that meet the definition of a derivative. Certain derivative energy contracts have been excluded from the requirements of derivative accounting treatment because they meet the definition of a NPNS. These contracts are accounted for using accrual accounting. All contracts that have been classified as derivative contracts are reflected on the balance sheet at their fair value. These contracts are recorded as "Price risk management assets" and "Price risk management liabilities" on the Balance Sheets. Short-term derivative positions are included in "Current Assets" and "Current Liabilities." PPL records long-term derivative positions in "Regulatory and Other Noncurrent Assets" and "Deferred Credits and Other Noncurrent Liabilities" and PPL Energy Supply records long-term derivative positions in "Other Noncurrent Assets" and "Deferred Credits and Other Noncurrent Liabilities." On the date the derivative contract is executed, PPL may designate the derivative as a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair value hedge"), a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow hedge"), a foreign currency fair value or cash flow hedge ("foreign currency hedge") or a hedge of a net investment in a foreign operation ("net investment hedge"). Changes in the fair value of derivatives are recorded in either OCI or in current-period earnings. Cash inflows and outflows related to derivative instruments are included as a component of operating, investing or financing activities on the Statements of Cash Flows, depending on the underlying nature of the hedged items.

See Note 18 for additional information on derivatives.

*(PPL and PPL Electric)*

To meet its obligation as a PLR to its customers, PPL Electric has entered into contracts that meet the definition of a derivative. These contracts have been excluded from the requirements of derivative accounting treatment because they meet the definition of a NPNS and are accounted for using accrual accounting. See Notes 17 and 18 for additional information.

### Revenue

#### Utility Revenue

*(PPL)*

The Statements of Income "Utility" line item contains revenues from domestic and U.K. rate-regulated delivery operations.

*(PPL Energy Supply)*

The Statements of Income "Utility" line item contains revenues from the U.K. rate-regulated delivery operations.

*(PPL Electric)*

Since most of PPL Electric's operations are regulated, it is not meaningful to use a "Utility" caption. Therefore, the revenues of PPL Electric are presented according to specific types of revenue.



## Revenue Recognition

*(PPL, PPL Energy Supply and PPL Electric)*

Operating revenues, except for "Energy-related businesses," are recorded based on energy deliveries through the end of the calendar month. Unbilled retail revenues result because customers' meters are read and bills are rendered throughout the month, rather than all being read at the end of the month. Unbilled revenues for a month are calculated by multiplying an estimate of unbilled kWh by the estimated average cents per kWh. Unbilled wholesale energy revenues are recorded at month-end to reflect estimated amounts until actual dollars and MWhs are confirmed and invoiced. At that time, unbilled revenue is reversed and actual revenue is recorded.

PPL Energy Supply records energy marketing activity in the period when the energy is delivered. Generally, the wholesale sales and purchases that qualify as derivative instruments held for non-trading purposes are reported gross on the Statements of Income within "Wholesale energy marketing" and "Energy purchases." Additionally, the bilateral sales and purchases that are designated as speculative trading activities and qualify as derivative instruments for accounting purposes are reported net on the Statements of Income within "Net energy trading margins." Spot market activity that balances PPL Energy Supply's physical trading positions is included on the Statements of Income in "Net energy trading margins."

Certain PPL subsidiaries participate in RTOs, primarily in PJM, but also in the surrounding regions of New York (NYISO), New England (ISO-NE) and the Midwest (MISO). In PJM, PPL EnergyPlus is a marketer, a load-serving entity to its customers who have selected it as a supplier and a seller for PPL's generation subsidiaries. PPL Electric is a transmission owner and PLR in PJM. In ISO-NE, PPL EnergyPlus is a marketer, a load-serving entity, and a seller for PPL's New England generating assets. In the NYISO and MISO regions, PPL EnergyPlus acts as a marketer. PPL Electric does not participate in ISO-NE, NYISO or MISO. A function of interchange accounting is to match participants' MWh entitlements (generation plus scheduled bilateral purchases) against their MWh obligations (load plus scheduled bilateral sales) during every hour of every day. If the net result during any given hour is an entitlement, the participant is credited with a spot-market sale to the ISO at the respective market price for that hour; if the net result is an obligation, the participant is charged with a spot-market purchase from the ISO at the respective market price for that hour. ISO purchases and sales are not allocated to individual customers. PPL records the hourly net sales and purchases in its financial statements as wholesale energy marketing and energy purchases.

"Energy-related businesses" revenue includes revenues from the mechanical contracting and engineering subsidiaries, as well as, WPD's telecommunications and property subsidiaries. The mechanical contracting and engineering subsidiaries record revenues from construction contracts on the percentage-of-completion method of accounting, measured by the actual cost incurred to date as a percentage of the estimated total cost for each contract. Accordingly, costs and estimated earnings in excess of billings on uncompleted contracts are recorded as a current asset on the Balance Sheets, and billings in excess of costs and estimated earnings on uncompleted contracts are recorded as a current liability on the Balance Sheets. The amount of costs in excess of billings was \$5 million and \$10 million at December 31, 2009 and 2008, and the amount of billings in excess of costs was \$69 million and \$80 million at December 31, 2009 and 2008.

*(PPL and PPL Energy Supply)*

During 2007, PPL recognized \$55 million of revenue related to a settlement agreement for cost-based payments based upon the RMR status of units at its Wallingford, Connecticut generating facility.

*( PPL and PPL Electric )*

Beginning November 1, 2008, PPL Electric's transmission revenues were billed in accordance with a FERC tariff that utilizes a formula-based rate recovery mechanism. The tariff allows for recovery of actual transmission costs incurred, a return on transmission plant placed in service and an incentive return, including a return on construction work in progress, on the Susquehanna-Roseland transmission line project. The tariff utilizes estimated costs for the current year billing to customers and requires a true-up to adjust for actual costs in the subsequent year's rate. In August 2009, the FERC approved this formula-based rate recovery mechanism. As a result, the annual update of the rate is now implemented automatically without requiring specific approval by the FERC before going into effect. PPL Electric accrues or defers revenues applicable to any estimated true-up of this formula-based rate. At December 31, 2009 a net asset of \$5 million was accrued, which will be reflected in future billings.

In 2009, PPL Electric recorded a \$3 million pre-tax true-up (\$2 million after-tax) related to the 2008 portion of the FERC formula-based transmission revenues. The true-up, reflected in the Pennsylvania Delivery segment for PPL, is not considered by management as material to the financial statements of PPL and PPL Electric for the years 2009 and 2008.

PPL Electric is charged transmission related costs by PJM applicable to PLR customers. PPL Electric passes these costs on to customers through an estimated transmission service charge and records a true-up to adjust for actual cost. Any over- or undercollections from customers are refunded or collected through a transmission service charge adjustment. At December 31, 2009, a liability of \$39 million was accrued on the Balance Sheet in "Other current liabilities" for PPL and as "Overcollected transmission costs" for PPL Electric.

## Allowance for Doubtful Accounts

*(PPL, PPL Energy Supply and PPL Electric)*

Accounts receivable are reported in the Balance Sheets at the gross outstanding amount adjusted for an allowance for doubtful accounts.

Accounts receivable collectability is evaluated using a combination of factors, including past due status based on contractual terms. Reserve

balances are analyzed to assess the reasonableness of the balances in comparison to the actual accounts receivable balances and write-offs. Adjustments are made to reserve balances based on the results of analysis, the aging of receivables, and historical and industry trends.

Additional specific reserves for uncollectible accounts receivable, such as bankruptcies, are recorded on a case-by-case basis after having been researched and reviewed by management. The nature of the item, trends in write-offs, the age of the receivable, counterparty creditworthiness and economic conditions are considered as a basis for determining the adequacy of the reserve for uncollectible account balances.

Accounts receivable are charged-off in the period in which the receivable is deemed uncollectible. Recoveries of accounts receivable previously charged-off are recorded when it is known they will be received.

The changes in the allowance for doubtful accounts, including unbilled revenues, were:

	Balance at Beginning of Period	Additions		Deductions (a)	Balance at End of Period
		Charged to Income	Charged to Other Accounts		
<b>PPL</b>					
2009	\$ 40	\$ 30		\$ 33	\$ 37
2008	40	29		29	40
2007	52	31		43	40
<b>PPL Energy Supply</b>					
2009	\$ 26	\$ 1		\$ 6	\$ 21
2008	22	5		1	26
2007	31			9	22
<b>PPL Electric</b>					
2009	\$ 14	\$ 29		\$ 27	\$ 16
2008	18	24		28	14
2007	19	29		30	18

(a) Primarily related to uncollectible accounts written off.

(PPL and PPL Energy Supply)

The California ISO reserves of \$17 million accounted for 46% and 47% of the total allowance for doubtful accounts of PPL and 81% of the total allowance of PPL Energy Supply at December 31, 2009 and 2008. See Note 14 for additional information.

Cash (PPL, PPL Energy Supply and PPL Electric)

#### Cash Equivalents

All highly liquid debt instruments purchased with original maturities of three months or less are considered to be cash equivalents.

#### Restricted Cash and Cash Equivalents

Bank deposits and other cash equivalents that are restricted by agreement or that have been clearly designated for a specific purpose are classified as restricted cash and cash equivalents. The change in restricted cash and cash equivalents is reported as an investing activity on the Statements of Cash Flows. On the Balance Sheets, the current portion of restricted cash and cash equivalents is shown as "Restricted cash and cash equivalents" while the noncurrent portion is included in "Other noncurrent assets" for PPL and PPL Energy Supply and in "Other regulatory and noncurrent assets" for PPL Electric. For PPL and PPL Energy Supply, the December 31, 2009 balance of restricted cash and cash equivalents consisted primarily of margin deposits posted by counterparties to PPL Energy Supply in connection with trading activities and the December 31, 2008 balance consisted primarily of margin deposits posted by PPL Energy Supply to counterparties in connection with trading activities. For PPL Electric, the December 31, 2009 and 2008 balances of restricted cash and cash equivalents, including the noncurrent portion, consisted primarily of funds deposited with a trustee to defease the First Mortgage Bonds. See Note 17 for the amounts recorded at December 31, 2009 and 2008.

Fair Value Measurements (PPL, PPL Energy Supply and PPL Electric)

PPL and its subsidiaries value certain financial and nonfinancial assets and liabilities at fair value. Generally, the most significant fair value measurements relate to price risk management assets and liabilities, investments in securities including investments in the NDT funds and defined benefit plans, and cash and cash equivalents. PPL and its subsidiaries use, as appropriate, a market approach (generally, data from market transactions), an income approach (generally, present value techniques and option-pricing models), and/or a cost approach (generally, replacement cost) to measure the fair value of an asset or liability. These valuation approaches incorporate inputs such as observable, independent market data and/or unobservable data that management believes are predicated on the assumptions market participants would use to price an asset or liability. These inputs may incorporate, as applicable, certain risks such as nonperformance risk, which includes credit risk.

PPL and its subsidiaries prioritize fair value measurements for disclosure by grouping them into one of three levels in the fair value hierarchy. The highest priority is given to measurements using Level 1 inputs. The appropriate level assigned to a fair value measurement is based on the lowest level input that is significant to the fair value measurement in its entirety. The three levels of the fair value hierarchy are as follows:

- **Level 1** - quoted prices (unadjusted) in active markets for identical assets or liabilities that are accessible at the measurement date. Active markets are those in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.
- **Level 2** - inputs other than quoted prices included within Level 1 that are either directly or indirectly observable for substantially the full term of the asset or liability.
- **Level 3** - unobservable inputs that management believes are predicated on the assumptions market participants would use to measure the asset or liability at fair value.

Assessing the significance of a particular input requires judgment that considers factors specific to the asset or liability. As such, PPL and its subsidiaries' assessment of the significance of a particular input may affect how the assets and liabilities are classified within the fair value hierarchy. See Notes 17 and 18 for additional information on fair value measurements.

### **Investments** (*PPL, PPL Energy Supply and PPL Electric*)

Generally, the original maturity date of an investment and management's ability to sell an investment prior to its original maturity determine the classification of investments as either short-term or long-term. Investments that would otherwise be classified as short-term, but are restricted as to withdrawal or use for other than current operations or are clearly designated for expenditure in the acquisition or construction of noncurrent assets or for the liquidation of long-term debts, are classified as long-term.

#### Short-term Investments

Short-term investments generally include certain deposits as well as securities that are considered highly liquid or provide for periodic reset of interest rates. Short-term investments have original maturities greater than three months and are included in "Short-term investments" on the Balance Sheets of PPL and PPL Energy Supply and in "Current Assets-Other" on the Balance Sheets of PPL Electric.

#### Investments in Debt and Equity Securities

Investments in debt securities are classified as held-to-maturity and measured at amortized cost when there is an intent and ability to hold the securities to maturity. Debt and equity securities that are acquired and held principally for the purpose of selling them in the near-term are classified as trading. Trading securities are generally held to capitalize on fluctuations in their value. All other investments in debt and equity securities are classified as available-for-sale. Both trading and available-for-sale securities are carried at fair value. The specific identification method is used to calculate realized gains and losses on debt and equity securities. Any unrealized gains and losses on trading securities are included in earnings. Through March 31, 2009, unrealized gains and losses on all available-for-sale securities were reported, net of tax, in OCI or recognized in earnings when the decline in fair value below amortized cost was determined to be an other-than-temporary impairment.

As described in "Recognition and Presentation of Other-Than-Temporary Impairments" within "New Accounting Guidance Adopted," new accounting guidance has modified the criteria for determining whether a decline in fair value of a debt security is other than temporary and whether the other-than-temporary impairment is recognized in earnings or reported in OCI. Beginning April 1, 2009, when a debt security is in an unrealized loss position:

- if there is an intent to sell the security or a requirement to sell the security before recovery, the other-than-temporary impairment is recognized currently in earnings; or
- if there is no intent to sell the security or requirement to sell the security before recovery, the portion of the other-than-temporary impairment that is considered a credit loss is recognized currently in earnings and the remainder of the other-than-temporary impairment is reported in OCI, net of tax; or
- if there is no intent to sell the security or requirement to sell the security before recovery and there is no credit loss, the unrealized loss is reported in OCI, net of tax.

Equity securities were not impacted by this new accounting guidance; therefore, unrealized gains and losses on available-for-sale equity securities continue to be reported, net of tax, in OCI. Earnings continue to be charged when an equity security's decline in fair value below amortized cost is determined to be an other-than-temporary impairment. See Notes 17 and 21 for additional information on investments in debt and equity securities.

### **Long-Lived and Intangible Assets**

#### Property, Plant and Equipment

(*PPL, PPL Energy Supply and PPL Electric*)

PP&E is recorded at original cost, unless impaired. If impaired, the asset is written down to fair value at that time, which becomes the new cost

basis of the asset. Original cost includes material, labor, contractor costs, certain overheads and financing costs, where applicable. The cost of repairs and minor replacements are charged to expense as incurred. PPL records costs associated with planned major maintenance projects in the period in which the costs are incurred. No costs are accrued in advance of the period in which the work is performed.

*PPL and PPL Electric)*

AFUDC is capitalized as part of the construction costs for regulated projects. The debt component of AFUDC is credited to "Interest Expense" and the equity component is credited to "Other Income - net" on the Statements of Income.

*(PPL and PPL Energy Supply)*

Nuclear fuel-related costs, including fuel, conversion, enrichment, fabrication and assemblies are capitalized as PP&E. Such costs are amortized over the period the fuel is spent using the unit-of-production method and included in "Fuel" on the Statements of Income.

PPL's unregulated entities and PPL Energy Supply capitalize interest costs as part of construction costs for non-regulated projects.

The following capitalized interest was excluded from "Interest Expense" on the Statements of Income.

	<u>PPL</u>		<u>PPL Energy Supply</u>	
2009	\$	44	\$	45
2008		57		56
2007		54		54

*(PPL, PPL Energy Supply and PPL Electric)*

Included in PP&E on the balance sheet are capitalized costs of software projects that were developed or obtained for internal use. These capitalized costs are amortized ratably over the expected lives of the projects when they become operational, generally not to exceed five years. Following are capitalized software costs and the accumulated amortization.

	<u>December 31, 2009</u>		<u>December 31, 2008</u>	
	<u>Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Carrying Amount</u>	<u>Accumulated Amortization</u>
PPL	\$ 97	\$ 52	\$ 62	\$ 39
PPL Energy Supply	24	19	24	18
PPL Electric	37	15	17	10

Amortization expense of capitalized software costs was as follows:

	<u>PPL</u>		<u>PPL Energy Supply</u>		<u>PPL Electric</u>	
2009	\$	13	\$	2	\$	5
2008		8		2		3
2007		10		2		4

The amortization of capitalized software is included in "Depreciation" on the Statements of Income.

Depreciation *(PPL, PPL Energy Supply and PPL Electric)*

Depreciation is computed over the estimated useful lives of property using various methods including the straight-line, composite and group methods. When a component of PP&E is retired that was depreciated under the composite or group method, the original cost is charged to accumulated depreciation. When all or a significant portion of an operating unit that was depreciated under the composite or group method is retired or sold, the property and the related accumulated depreciation account is reduced and any gain or loss is included in income, unless otherwise required by regulators.

In 2007, WPD reviewed the useful lives of its distribution network assets. Effective April 1, 2007, after considering information from Ofgem and other internal and external surveys, the weighted average useful lives were extended to 54 years from 40 years. The effect of this change in useful lives for 2007 was to increase income from continuing operations after income taxes attributable to PPL/PPL Energy Supply and net income attributable to PPL/PPL Energy Supply, as a result of lower depreciation, by \$13 million (or \$0.03 per share, basic and diluted, for PPL).

Following are the weighted-average rates of depreciation at December 31.

	<u>2009</u>		
	<u>PPL</u>	<u>PPL Energy Supply</u>	<u>PPL Electric</u>

Generation	2.48%	2.48%	
Transmission and distribution	2.17%	2.33%	2.04%
General	7.32%	10.19%	4.00%

	2008		
	<u>PPL</u>	<u>PPL Energy Supply</u>	<u>PPL Electric</u>
Generation	2.39%	2.39%	
Transmission and distribution	2.58%	3.07%	2.20%
General	8.09%	11.6%	4.33%

The annual provisions for depreciation have been computed principally in accordance with the following ranges, in years, of assets lives.

	2008		
	<u>PPL</u>	<u>PPL Energy Supply</u>	<u>PPL Electric</u>
Generation	40-50	40-50	
Transmission and distribution	5-70	5-60	15-70
General	3-60	3-60	5-55

#### Goodwill and Other Intangible Assets (PPL, PPL Energy Supply and PPL Electric)

Goodwill represents the excess of the purchase price paid over the estimated fair value of the assets acquired and liabilities assumed in the acquisition of a business. PPL's reporting units are significant businesses that have discrete financial information and the operating results are regularly reviewed by segment management.

Other acquired intangible assets are initially measured based on their fair value. Intangibles that have finite useful lives are amortized over their useful lives based upon the pattern in which the economic benefits of the intangible assets are consumed or otherwise used. Costs incurred to renew or extend terms of licenses are capitalized as intangible assets.

When determining the useful life of an intangible asset, including intangible assets that are renewed or extended, PPL and its subsidiaries consider: the expected use of the asset; the expected useful life of other assets to which the useful life of the intangible asset may relate; legal, regulatory, or contractual provisions that may limit the useful life; the company's historical experience as evidence of its ability to support renewal or extension; the effects of obsolescence, demand, competition, and other economic factors; and the level of maintenance expenditures required to obtain the expected future cash flows from the asset.

PPL and its subsidiaries account for emission allowances as intangible assets. Since the economic benefits of emission allowances are not diminished until they are consumed, emission allowances are not amortized; rather they are expensed when consumed. Such expense is included in "Fuel" on the Statements of Income. Gains and losses on the sale of emission allowances are included in "Other operation and maintenance" on the Statements of Income. In addition, "vintage year" swaps are accounted for as nonmonetary transactions that are required to be measured at fair value. Certain emission allowances are expected to be sold rather than consumed. These emission allowances are tested for impairment when events or changes in circumstances, such as a decline in market prices, indicate that their carrying value might be impaired.

PPL and its subsidiaries also account for RECs as intangible assets and the associated costs are not expensed until the credits are consumed. Such expense is included in "Energy purchases" on the Statements of Income. Gains and losses on the sale of RECs are included in "Other operating and maintenance" on the Statements of Income.

See Note 19 for additional information on goodwill and other intangible assets.

#### Asset Impairment (PPL, PPL Energy Supply and PPL Electric)

PPL and its subsidiaries review long-lived assets that are subject to depreciation or amortization, including finite-lived intangibles, for impairment when events or circumstances indicate carrying amounts may not be recoverable.

For a long-lived asset to be held and used, an impairment exists when the carrying amount exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. If the asset is impaired, an impairment loss is recorded to adjust the asset's carrying amount to its fair value. See Notes 8 and 17 for a discussion of impairment charges recorded associated with long-lived assets to be held and used.

For a long-lived asset held for sale, an impairment exists when the carrying amount of the asset (disposal group) exceeds its fair value less cost to sell. If the asset (disposal group) is impaired, an impairment loss is recorded to adjust the carrying amount of the asset (disposal group) to its fair value less cost to sell. See Notes 9 and 17 for a discussion of impairment charges recorded associated with long-lived assets held for sale.

Goodwill is reviewed for impairment, at the reporting unit level, annually or more frequently when events or circumstances indicate that the carrying amount of a reporting unit may be greater than the unit's fair value. Additionally, goodwill must be tested for impairment after a portion of goodwill has been allocated to a business to be disposed of. PPL's reporting units are at or one level below its operating segments. If the carrying amount of the reporting unit, including goodwill, exceeds its fair value, the implied fair value of goodwill must be calculated. The implied fair value of goodwill is determined in the same manner as the amount of goodwill in a business combination. That is, the fair value of a reporting unit is allocated to all assets and liabilities of that unit as if the reporting unit had been acquired in a business combination. The excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of goodwill. If the implied fair value of goodwill is less than the carrying amount, an impairment loss is recognized for an amount equal to that difference.

#### Asset Retirement Obligations (PPL, PPL Energy Supply and PPL Electric)

PPL and its subsidiaries recognize various legal obligations associated with the retirement of long-lived assets as liabilities in the financial statements. Initially this obligation is measured at fair value. An equivalent amount is recorded as an increase in the value of the capitalized asset and allocated to expense over the useful life of the asset. Until the obligation is settled, the liability is increased, through the recognition of accretion expense in the income statement, for changes in the obligation due to the passage of time. Estimated ARO costs and settlement dates, which affect the carrying value of various AROs and the related assets, are reviewed periodically to ensure that any material changes are incorporated into the latest estimate of the obligations.

See Note 20 for a discussion of accounting for AROs.

#### **Compensation and Benefits**

##### Defined Benefits (PPL, PPL Energy Supply and PPL Electric)

PPL and certain of its subsidiaries sponsor various defined benefit pension and other postretirement plans. An asset or liability is recorded to recognize the funded status of all defined benefit plans with an offsetting entry to OCI or regulatory assets for PPL Electric. Consequently, the funded status of all defined benefit plans is fully recognized on the Balance Sheets.

The expected return on plan assets is determined based on a market-related value of plan assets, which is calculated by rolling forward the prior year market-related value with contributions, disbursements and long-term expected return on investments. One-fifth of the difference between the actual value and the expected value is added (or subtracted if negative) to the expected value to determine the new market-related value.

PPL uses an accelerated amortization method for the recognition of gains and losses for its pension plans. Under the accelerated method, gains and losses in excess of 10% but less than 30% of the greater of the plan's projected benefit obligation or the market-related value of plan assets are amortized on a straight-line basis over the estimated average future service period of plan participants. Gains and losses in excess of 30% of the plan's projected benefit obligation are amortized on a straight-line basis over a period equal to one-half of the average future service period of the plan participants.

See Note 12 for a discussion of defined benefits.

##### Stock-Based Compensation

(PPL, PPL Energy Supply and PPL Electric)

PPL grants stock options, restricted stock, restricted stock units and performance units to certain employees, and stock units and restricted stock units to directors, under several stock-based compensation plans. PPL and its subsidiaries recognize compensation expense for stock-based awards based on the fair value method. Stock options with graded vesting (i.e., that vest in installments) are valued as a single award. PPL grants stock options with an exercise price that is not less than the fair value of PPL's common stock on the date of grant. See Note 11 for a discussion of stock-based compensation. Stock-based compensation is included in "Other operation and maintenance" expense on the Statements of Income.

(PPL Energy Supply and PPL Electric)

PPL Energy Supply's and PPL Electric's stock-based compensation expense includes an allocation of PPL Services' expense.

#### **Other**

##### Income Taxes

(PPL, PPL Energy Supply and PPL Electric)

PPL and its domestic subsidiaries file a consolidated U.S. federal income tax return.

Significant management judgment is required in developing PPL and its subsidiaries' provision for income taxes primarily due to the uncertainty related to tax positions taken or expected to be taken in tax returns and the determination of deferred tax assets, liabilities and valuation allowances.

Significant management judgment is required to determine the amount of benefit to be recognized in relation to an uncertain tax position. PPL and its subsidiaries evaluate tax positions following a two-step process. The first step requires an entity to determine whether, based on the technical merits supporting a particular tax position, it is more likely than not (greater than a 50% chance) that the tax position will be sustained. This determination assumes that the relevant taxing authority will examine the tax position and is aware of all the relevant facts surrounding the tax position. The second step requires an entity to recognize in the financial statements the benefit of a tax position that meets the more-likely-than-not recognition criterion. The benefit recognized is measured at the largest amount of benefit that has a likelihood of realization, upon settlement, that exceeds 50%. The amounts ultimately paid upon resolution of issues raised by taxing authorities may differ materially from the amounts accrued and may materially impact the financial statements of PPL and its subsidiaries in the future.

Deferred income taxes reflect the net future tax effects of temporary differences between the carrying amounts of assets and liabilities for accounting purposes and their basis for income tax purposes, as well as the tax effects of net operating losses and tax credit carryforwards.

PPL and its subsidiaries record valuation allowances to reduce deferred tax assets to the amounts that are more likely than not to be realized. PPL and its subsidiaries consider the reversal of temporary differences, future taxable income and ongoing prudent and feasible tax planning strategies in initially recording and subsequently reevaluating the need for valuation allowances. If PPL and its subsidiaries determine that they are able to realize deferred tax assets in the future in excess of recorded net deferred tax assets, adjustments to the valuation allowances increase income by reducing tax expense in the period that such determination is made. Likewise, if PPL and its subsidiaries determine that they are not able to realize all or part of net deferred tax assets in the future, adjustments to the valuation allowances would decrease income by increasing tax expense in the period that such determination is made.

PPL Energy Supply and PPL Electric defer investment tax credits when the credits are utilized and are amortizing the deferred amounts over the average lives of the related assets.

See Note 5 for additional discussion regarding income taxes.

*(PPL Energy Supply and PPL Electric)*

The income tax provision for PPL Energy Supply and PPL Electric is calculated in accordance with an intercompany tax sharing policy which provides that taxable income be calculated as if PPL Energy Supply, PPL Electric and any domestic subsidiaries each filed a separate consolidated return. PPL Energy Supply's intercompany tax receivable was \$21 million and \$15 million at December 31, 2009 and 2008. PPL Electric's intercompany tax receivable was \$19 million and \$15 million at December 31, 2009 and 2008.

*(PPL and PPL Electric)*

The provision for PPL Electric's deferred income taxes for regulated assets is based upon the ratemaking principles reflected in rates established by the PUC and the FERC. The difference in the provision for deferred income taxes for regulated assets and the amount that otherwise would be recorded under GAAP is deferred and included on the Balance Sheet in taxes recoverable through future rates in "Regulatory assets" for PPL and in "Taxes recoverable through future rates" for PPL Electric.

Taxes, Other Than Income *(PPL, PPL Energy Supply and PPL Electric)*

PPL and its subsidiaries present sales taxes in "Accounts Payable" and value-added taxes in "Taxes" on their Balance Sheets. These taxes are not reflected on the Statements of Income. See Note 5 for details on taxes included in "Taxes, other than income" on the Statements of Income.

#### Leases

*(PPL, PPL Energy Supply and PPL Electric)*

PPL and its subsidiaries evaluate whether arrangements entered into contain leases for accounting purposes.

*(PPL and PPL Energy Supply)*

See Note 10 for a discussion of arrangements under which PPL and PPL Energy Supply are lessees for accounting purposes.

PPL EnergyPlus has entered into several arrangements whereby PPL EnergyPlus is considered the lessor for accounting purposes. See Note 10 for additional information on these leases and Note 9 for information regarding the anticipated sale of the Long Island generation business, which includes certain of these leases.

#### Fuel, Materials and Supplies

*(PPL, PPL Energy Supply and PPL Electric)*

Fuel, materials and supplies are valued at the lower of cost or market using the average cost method.

*(PPL and PPL Energy Supply)*

Fuel, materials and supplies consisted of the following at December 31:

	PPL		PPL Energy Supply	
	2009	2008	2009	2008
uel	\$ 151	\$ 140	\$ 151	\$ 140
Materials and supplies	206	197	174	161
	<u>\$ 357</u>	<u>\$ 337</u>	<u>\$ 325</u>	<u>\$ 301</u>

Guarantees (PPL, PPL Energy Supply and PPL Electric)

Generally, the initial measurement of a guarantee liability is the fair value of the guarantee at its inception. However, there are certain guarantees excluded from the scope of accounting guidance and other guarantees that are not subject to the initial recognition and measurement provisions of accounting guidance. See Note 14 for further discussion of recorded and unrecorded guarantees.

Treasury Stock (PPL and PPL Electric)

PPL and PPL Electric restore all shares of common stock acquired to authorized but unissued shares of common stock upon acquisition.

Foreign Currency Translation and Transactions (PPL and PPL Energy Supply)

Assets and liabilities of international subsidiaries, where the local currency is the functional currency, are translated at the exchange rates on the date of consolidation and related revenues and expenses are translated at average exchange rates prevailing during the year. See "Business and Consolidation" above for a discussion regarding the use of a lag period. Adjustments resulting from translation are recorded in AOCI. The effect of translation is removed from AOCI upon the sale or substantial liquidation of the international subsidiary that gave rise to the translation adjustment. The local currency is the functional currency for PPL's U.K. operating company.

At December 31, 2009, the British pound sterling had strengthened in relation to the U.S. dollar as compared with the prior year end. Changes in exchange rates resulted in a foreign currency translation gain of \$106 million for 2009, which primarily reflected a \$225 million increase in PP&E offset by an increase of \$119 million to other net liabilities. At December 31, 2008, the British pound sterling had weakened in relation to the U.S. dollar compared with the prior year end. Changes in these exchange rates resulted in a foreign currency translation loss of \$520 million for 2008, which primarily reflected a \$1.1 billion reduction to PP&E offset by a reduction of \$580 million to other net liabilities. Changes in exchange rates resulted in a foreign currency translation gain of \$65 million for 2007, which primarily reflected a \$173 million increase in PP&E offset by an increase of \$108 million to other net liabilities.

Gains or losses relating to foreign currency transactions are recognized currently in income. The net transaction losses were insignificant in 2009 and 2007, and \$2 million in 2008.

**New Accounting Guidance Adopted** (PPL, PPL Energy Supply and PPL Electric)

Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)

Effective January 1, 2009, PPL and its subsidiaries retrospectively adopted accounting guidance that requires an issuer to separately account for the liability and equity components of convertible debt instruments that may be settled in cash (or other assets) upon conversion in a manner that reflects the issuer's nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. The discount that results from separating the liability and equity components will be amortized over the life of the debt and recognized as interest expense.

This guidance was applicable to PPL Energy Supply's 2-5/8% Convertible Senior Notes due 2023 (Convertible Senior Notes), which upon conversion required cash settlement of the principal amount and permitted settlement of any conversion premium in cash or PPL common stock. During 2008, all of the Convertible Senior Notes were either converted at the election of the holders or redeemed at par as a result of PPL Energy Supply calling the notes for redemption. This guidance required only retrospective application with regard to the Convertible Senior Notes, as none of these notes were outstanding at the effective date. The retrospective application impacted PPL in periods prior to 2006. As such, PPL reduced the opening balance of "Earnings reinvested" by \$13 million with a corresponding increase to "Capital in excess of par value."

Business Combinations

Effective January 1, 2009, PPL and its subsidiaries prospectively adopted accounting guidance that changes the accounting and reporting for business combinations occurring after its adoption. In addition, this guidance requires entities to recognize changes in unrecognized tax benefits acquired in a business combination, including business combinations that occurred prior to January 1, 2009, in income tax expense rather than in goodwill. The January 1, 2009 adoption did not have a significant impact on PPL and its subsidiaries; however, the impact in future periods could be material.

In the first quarter of 2009, PPL and PPL Energy Supply recorded an income tax benefit of \$14 million as a result of settling an income tax dispute. Prior to the adoption of this guidance, \$7 million of this income tax benefit would have been recorded as a reduction to goodwill.

Noncontrolling Interests in Consolidated Financial Statements



Effective January 1, 2009, PPL and its subsidiaries adopted accounting guidance that was issued to improve the relevancy, comparability, and transparency of the financial information an entity provides when it has a noncontrolling interest in a subsidiary and when it changes its ownership interest in a subsidiary. This guidance:

- requires ownership interests in subsidiaries held by parties other than the parent to be presented in the consolidated statement of financial position within equity, but separate from the parent's equity;
- requires the amount of consolidated net income attributable to the parent and to the noncontrolling interest to be presented on the face of the consolidated statement of income;
- addresses the accounting for changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary and for the deconsolidation of a subsidiary; and
- requires enhanced disclosures relating to noncontrolling interests.

PPL and its subsidiaries adopted this guidance prospectively except for the presentation and disclosure requirements, which required retrospective application.

At December 31, 2009 and 2008, PPL reflected PPL Electric's preferred securities of \$301 million within "Noncontrolling Interests" on the Balance Sheets. In addition, at December 31, 2009 and 2008, PPL and PPL Energy Supply reflected previously recorded minority interests of \$18 million within "Noncontrolling Interests" on the Balance Sheets.

#### Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities

Effective January 1, 2009, PPL and its subsidiaries retrospectively adopted accounting guidance that requires unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents to be considered participating securities and to be included in the computation of EPS under the two-class method. The two-class method treats share-based payment awards that pay nonforfeitable dividends as a separate class of stock for purposes of computing EPS.

The adoption did not have a material impact on PPL and its subsidiaries. As a result of its application, PPL's restricted stock, restricted stock units, and stock units granted to directors are now considered participating securities; therefore, PPL is required to compute EPS under the two-class method. For the years ended December 31, 2008, the retrospective application caused PPL's basic EPS for income from continuing operations after income taxes available to PPL Corporation common shareholders to decrease by \$0.01 and basic EPS for net income available to PPL Corporation common shareowners to decrease by \$0.01. For the year ended December 31, 2007, the retrospective application caused PPL's basic EPS for income from continuing operations after income taxes available to PPL Corporation common shareholders to decrease by \$0.01 and basic EPS for net income available to PPL Corporation common shareowners to decrease by \$0.02. Additionally, PPL's diluted EPS for net income available to PPL Corporation common shareowners decreased by \$0.01 for the year ended December 31, 2007. See Note 4 for additional information.

#### Disclosures about Derivative Instruments and Hedging Activities

Effective January 1, 2009, PPL and its subsidiaries prospectively adopted accounting guidance that applies to all derivative instruments, including bifurcated derivative instruments and nonderivative instruments that are designated and qualify as hedging instruments, as well as related hedged items. This guidance requires an entity to expand disclosures to provide greater transparency about:

- how and why it uses derivative instruments;
- how derivative instruments and related hedged items are accounted for; and
- how derivative instruments and related hedged items affect its financial position, results of operations and cash flows.

The guidance was issued to provide greater transparency by enhancing existing disclosures; therefore, the adoption did not have a material impact on PPL and its subsidiaries' financial statements. The enhanced disclosures are presented in Note 18.

#### Fair Value Measurements

Effective January 1, 2008, PPL and its subsidiaries adopted accounting guidance that provides a framework for measuring fair value, but elected to defer, until 2009, applying this guidance to nonfinancial assets and nonfinancial liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis. Effective January 1, 2009, PPL and its subsidiaries fully applied this guidance to fair value measurement concepts used within their financial statements where applicable.

#### Issuer's Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement

Effective January 1, 2009, PPL and its subsidiaries prospectively adopted accounting guidance that applies to liabilities issued with an inseparable third-party credit enhancement when the liability is measured or disclosed at fair value on a recurring basis. This guidance indicates that an issuer shall disclose the existence of a third-party credit enhancement, and the fair value measurement of the liability shall not include the effect of this third-party credit enhancement.

The initial adoption did not have a material impact on PPL and its subsidiaries' financial statements, as this guidance only impacts the fair value disclosure of certain credit-enhanced debt instruments. See "Financial Instruments Not Recorded at Fair Value" within Note 17 for these disclosures.

## Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly

Effective April 1, 2009, PPL and its subsidiaries prospectively adopted accounting guidance that:

- provides additional direction for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased;
- includes guidance on identifying circumstances that indicate a transaction is not orderly; and
- emphasizes that the objective of a fair value measurement remains the same; that is, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date under current market conditions.

Comparative disclosures are required only for periods ending after initial adoption. The adoption did not have a material impact on PPL and its subsidiaries' financial statements.

## Recognition and Presentation of Other-Than-Temporary Impairments

Effective April 1, 2009, PPL and its subsidiaries retrospectively adopted accounting guidance that modified the requirement that an entity have the intent and ability to hold an impaired debt security to recovery in order to conclude an impairment was temporary. Under this guidance, an impairment of a debt security is other than temporary if (1) an entity has the intent to sell the security, (2) it is more likely than not that an entity will be required to sell the security before recovery, or (3) an entity does not expect to recover the entire amortized cost basis of the security, referred to as a credit loss.

In addition, this guidance changes the recording of an other-than-temporary impairment on a debt security if the reason for the other-than-temporary impairment is the recognition of a credit loss. In this situation, the other-than-temporary impairment will be separated into the credit loss component, which is recognized in earnings, and the remainder of the other-than-temporary impairment, which is recorded in OCI.

For a debt security held at the beginning of the period of adoption for which an other-than-temporary impairment was previously recognized, if an entity does not intend to sell the debt security and it is not more likely than not that the entity will be required to sell the debt security before recovery of its amortized cost basis, the cumulative effect of applying this guidance was recognized as an adjustment to the opening balance of retained earnings with a corresponding adjustment to AOCI.

This guidance affects the accounting for PPL's and PPL Energy Supply's investments in debt securities in the NDT funds. Prior to its application, PPL and PPL Energy Supply were unable to demonstrate the ability to hold an impaired debt security in the NDT funds until recovery; therefore, an unrealized loss on a debt security always represented an other-than-temporary impairment that required a current period charge to earnings. Based on the application of this guidance, certain unrealized losses on investments in debt securities are no longer considered other-than-temporary impairments and will be recorded to OCI.

Related SEC guidance was also amended to no longer apply to debt securities. As a result of the adoption, PPL and PPL Energy Supply recorded an immaterial cumulative effect adjustment to the opening balance of retained earnings with a corresponding reduction to AOCI.

## The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles

Beginning with the period ended September 30, 2009, PPL and its subsidiaries adopted accounting guidance that establishes the FASB Accounting Standards Codification™ (ASC) as the primary source of authoritative GAAP, other than guidance issued by the SEC. This guidance eliminates the previous GAAP hierarchy of accounting and reporting guidance and replaces it with two levels of literature: authoritative and non-authoritative, and organizes GAAP pronouncements in a consistent manner by accounting topic. The adoption did not impact PPL and its subsidiaries' results of operations, cash flows or financial positions since the ASC did not change existing GAAP.

## Employers' Disclosures about Pensions and Other Postretirement Benefits

Effective December 31, 2009, PPL and its subsidiaries prospectively adopted accounting guidance that requires an employer to enhance its disclosures about plan assets of defined benefit plans to provide users of financial statements with an understanding of:

- how investment allocation decisions are made, including the factors that are pertinent to an understanding of investment policies and strategies;
- the major classes of plan assets;
- the inputs and valuation techniques used to measure the fair value of plan assets;
- the effect of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets for the period; and
- significant concentrations of risk within plan assets.

This guidance was issued to provide greater transparency within disclosures; therefore, the adoption did not have a material impact on PPL and its subsidiaries' financial statements. The enhanced disclosures are presented in Note 12.

## **New Accounting Guidance Pending Adoption**

See Note 22 for a discussion of new accounting guidance pending adoption.

## 2. Segment and Related Information

*(PPL and PPL Energy Supply)*

PPL's reportable segments are Supply, International Delivery and Pennsylvania Delivery. The Supply segment primarily consists of the domestic energy marketing and trading activities, as well as the generation and development operations of PPL Energy Supply. In 2009 and 2007, PPL Energy Supply sold or agreed to sell certain Supply segment businesses. See Notes 8 and 9 for additional information.

The International Delivery segment consists primarily of the electricity distribution operations in the U.K. In 2007, PPL completed the sale of its Latin American businesses. In 2008, the International Delivery segment recognized income tax benefits and miscellaneous expenses in Discontinued Operations in connection with the dissolution of certain Latin American holding companies. In 2009, the International Delivery segment recognized \$24 million of income tax expense in Discontinued Operations related to a correction of the calculation of tax bases of the Latin American businesses sold in 2007. See Note 9 for additional information.

The Pennsylvania Delivery segment includes the regulated electric delivery operations of PPL Electric. This segment also included the gas delivery operations of PPL Gas Utilities prior to its sale in October 2008. See Note 9 for additional information.

The operating results of the Long Island generation business, the majority of the Maine hydroelectric generation business, the Latin American businesses and the natural gas distribution and propane businesses have been classified as Discontinued Operations on the Statements of Income. Therefore, with the exception of net income attributable to PPL/PPL Energy Supply, the operating results from these businesses have been excluded from the income statement data tables below.

PPL Energy Supply's reportable segments are Supply and International Delivery. The International Delivery segment at the PPL Energy Supply level is consistent with the International Delivery segment at the PPL level. The Supply segment information reported at the PPL Energy Supply level will not agree with the Supply segment information reported at the PPL level because additional Supply segment functions exist at PPL that are outside of PPL Energy Supply. Furthermore, certain income items, including PLR revenue and certain interest income, exist at the PPL Energy Supply level but are eliminated in consolidation at the PPL level. Finally, certain expense items are fully allocated to the segments at the PPL level only.

Segments include direct charges, as well as an allocation of indirect corporate service costs, from PPL Services. These service costs include functions such as financial, legal, human resources and information services. See Note 15 for additional information.

Financial data for the segments are:

	PPL			PPL Energy Supply		
	2009	2008	2007	2009	2008	2007
<b>Income Statement Data</b>						
Revenues from external customers						
Supply (a)	\$ 3,618	\$ 3,857	\$ 2,308	\$ 5,416	\$ 5,678	\$ 4,112
International Delivery	716	857	900	716	857	900
Pennsylvania Delivery	3,222	3,293	3,254			
	<u>7,556</u>	<u>8,007</u>	<u>6,462</u>	<u>6,132</u>	<u>6,535</u>	<u>5,012</u>
Intersegment revenues (b)						
Supply	1,806	1,826	1,810			
Pennsylvania Delivery	70	108	156			
Depreciation						
Supply	226	193	163	210	180	152
International Delivery	115	134	147	115	134	147
Pennsylvania Delivery	128	131	132			
	<u>469</u>	<u>458</u>	<u>442</u>	<u>325</u>	<u>314</u>	<u>299</u>
Amortization - recoverable transition costs and other						
Supply	90	66	106	88	51	94
International Delivery	(13)	15	10	(13)	15	10
Pennsylvania Delivery	312	302	317			
	<u>389</u>	<u>383</u>	<u>433</u>	<u>75</u>	<u>66</u>	<u>104</u>
Unrealized (gains) losses on derivatives and other hedging activities						
Supply	329	(279)	(22)	330	(285)	(27)
Interest income (c)						
Supply	2	7	11	7	27	55

International Delivery	1	10	22	1	10	22
Pennsylvania Delivery	11	16	28			
	<u>14</u>	<u>33</u>	<u>61</u>	<u>8</u>	<u>37</u>	<u>77</u>
Interest Expense (d)						
Supply	191	200	154	185	169	106
International Delivery	87	144	183	87	144	183
Pennsylvania Delivery	118	111	135			
	<u>396</u>	<u>455</u>	<u>472</u>	<u>272</u>	<u>313</u>	<u>289</u>
Income from Continuing Operations Before Income Taxes						
Supply	85	749	780	44	755	835
International Delivery	290	330	260	290	330	260
Pennsylvania Delivery	221	278	241			
	<u>596</u>	<u>1,357</u>	<u>1,281</u>	<u>334</u>	<u>1,085</u>	<u>1,095</u>
Income Taxes						
Supply	31	283	221	27	290	249
International Delivery	20	45	(43)	20	45	(43)
Pennsylvania Delivery	79	102	81			
	<u>130</u>	<u>430</u>	<u>259</u>	<u>47</u>	<u>335</u>	<u>206</u>
Deferred income taxes and investment tax credits						
Supply	138	112	6	152	193	120
International Delivery	12	1	(38)	12	1	(38)
Pennsylvania Delivery	(23)	1	18			
	<u>127</u>	<u>114</u>	<u>(14)</u>	<u>164</u>	<u>194</u>	<u>82</u>
Net Income Attributable to PPL/PPL Energy Supply						
Supply (a) (e)	40	479	568	3	478	595
International Delivery (f)	243	290	610	243	290	610
Pennsylvania Delivery (g)	124	161	110			
	<u>\$ 407</u>	<u>\$ 930</u>	<u>\$ 1,288</u>	<u>\$ 246</u>	<u>\$ 768</u>	<u>\$ 1,205</u>
<b>Cash Flow Data</b>						
Expenditures for long-lived assets						
Supply	\$ 723	\$ 1,142	\$ 1,043	\$ 694	\$ 1,117	\$ 1,019
International Delivery	240	267	340	240	267	340
Pennsylvania Delivery	298	286	302			
	<u>\$ 1,261</u>	<u>\$ 1,695</u>	<u>\$ 1,685</u>	<u>\$ 934</u>	<u>\$ 1,384</u>	<u>\$ 1,359</u>

	PPL		PPL Energy Supply	
	As of December 31,		As of December 31,	
	2009	2008	2009	2008
<b>Balance Sheet Data</b>				
Total assets				
Supply	\$ 12,766	\$ 11,993	\$ 12,508	\$ 12,270
International Delivery	4,516	4,199	4,516	4,199
Pennsylvania Delivery	4,883	5,213		
	<u>\$ 22,165</u>	<u>\$ 21,405</u>	<u>\$ 17,024</u>	<u>\$ 16,469</u>

	PPL			PPL Energy Supply		
	2009	2008	2007	2009	2008	2007
<b>Geographic Data</b>						
Revenues from external customers						
U.S.	\$ 6,840	\$ 7,150	\$ 5,562	\$ 5,416	\$ 5,678	\$ 4,112
U.K.	716	857	900	716	857	900
	<u>\$ 7,556</u>	<u>\$ 8,007</u>	<u>\$ 6,462</u>	<u>\$ 6,132</u>	<u>\$ 6,535</u>	<u>\$ 5,012</u>

PPL	PPL Energy Supply
As of December 31,	As of December 31,

	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Long-Lived Assets				
U.S.	\$ 10,181	\$ 9,762	\$ 6,676	\$ 6,433
U.K.	<u>3,517</u>	<u>3,167</u>	<u>3,517</u>	<u>3,167</u>
	\$ 13,698	\$ 12,929	\$ 10,193	\$ 9,600

- (a) Includes unrealized gains and losses from economic activity. See Note 18 for additional information.
- (b) See "PLR Contracts" and "NUG Purchases" in Note 15 for a discussion of the basis of accounting between reportable segments.
- (c) Includes interest income from affiliate(s).
- (d) Includes interest expense with affiliate.
- (e) Includes the results of Discontinued Operations of the Long Island generation business and the majority of the Maine hydroelectric generation business. Also includes the loss on the sale of PPL Energy Supply's interest in Wyman Unit 4. See Note 9 for additional information.
- (f) Includes the results of Discontinued Operations of the Latin American businesses. See Note 9 for additional information.
- (g) Includes the results of Discontinued Operations of the natural gas and propane businesses. See Note 9 for additional information.

### 3. Variable Interest Entities

*(PPL and PPL Energy Supply)*

In December 2001, a subsidiary of PPL Energy Supply entered into a \$455 million operating lease arrangement, as lessee, for the development, construction and operation of a gas-fired combined-cycle generation facility located in Lower Mt. Bethel Township, Northampton County, Pennsylvania. This generation facility has a total capacity (winter rating) of 624 MW at December 31, 2009. The owner/lessor of this generation facility, LMB Funding, LP, was created to own/lease the facility and incur the related financing costs. The initial lease term commenced on the date of commercial operation, which occurred in May 2004, and ends in December 2013. Under a residual value guarantee, if the generation facility is sold at the end of the lease term and the cash proceeds from the sale are less than the original acquisition cost, the subsidiary of PPL Energy Supply is obligated to pay up to 70.52% of the original acquisition cost. This residual value guarantee protects the other variable interest holders from losses related to their investments. LMB Funding, LP cannot extend or cancel the lease or sell the facility without the prior consent of the PPL Energy Supply subsidiary. As a result, LMB Funding, LP was determined to be a variable interest entity and the subsidiary of PPL Energy Supply was considered the primary beneficiary that consolidates this variable interest entity.

The lease financing, which includes \$437 million of "Long-term Debt" and \$18 million of "Noncontrolling Interests," at December 31, 2009, is secured by, among other things, the generation facility. The debt matures at the end of the lease. At December 31, 2009 and 2008, the facility, which was included in "Property, Plant and Equipment" and "Other intangibles" on the Balance Sheets, had a carrying value of \$435 million and \$441 million, net of accumulated depreciation and amortization of \$48 million and \$51 million.

### 4. Earnings Per Share

*(PPL)*

The basic and diluted EPS computations and reconciliations of the amounts of income and shares (in thousands) of common stock used in the calculations are:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>Income (Numerator)</b>			
Income from continuing operations after income taxes attributable to PPL	\$ 447	\$ 907	\$ 1,001
Less amounts allocated to participating securities	<u>2</u>	<u>5</u>	<u>5</u>
Income from continuing operations after income taxes available to PPL common shareowners	<u>\$ 445</u>	<u>\$ 902</u>	<u>\$ 996</u>
Income (loss) from discontinued operations (net of income taxes) attributable to PPL	\$ (40)	\$ 23	\$ 287
Less amounts allocated to participating securities			<u>1</u>
Income (loss) from discontinued operations (net of income taxes) available to PPL common shareowners	<u>\$ (40)</u>	<u>\$ 23</u>	<u>\$ 286</u>
Net income attributable to PPL	\$ 407	\$ 930	\$ 1,288
Less amounts allocated to participating securities	<u>2</u>	<u>5</u>	<u>6</u>
Net income available to PPL common shareowners	<u>\$ 405</u>	<u>\$ 925</u>	<u>\$ 1,282</u>
<b>Shares of Common Stock (Denominator)</b>			
Weighted-average shares - Basic EPS	376,082	373,626	380,563
Additional incremental non-participating securities:			
Stock options and performance units	324	836	1,328
Convertible Senior Notes		<u>439</u>	<u>1,601</u>

Weighted-average shares - Diluted EPS	<u>376,406</u>	<u>374,901</u>	<u>383,492</u>
<b>Basic EPS</b>			
Available to PPL common shareowners:			
Income from continuing operations after income taxes	\$ 1.18	\$ 2.42	\$ 2.62
Income (loss) from discontinued operations (net of income taxes)	<u>(0.10)</u>	<u>0.06</u>	<u>0.75</u>
Net Income	<u>\$ 1.08</u>	<u>\$ 2.48</u>	<u>\$ 3.37</u>

**Diluted EPS**

Available to PPL common shareowners:			
Income from continuing operations after income taxes	\$ 1.18	\$ 2.41	\$ 2.60
Income (loss) from discontinued operations (net of income taxes)	<u>(0.10)</u>	<u>0.06</u>	<u>0.74</u>
Net Income	<u>\$ 1.08</u>	<u>\$ 2.47</u>	<u>\$ 3.34</u>

While they were outstanding, PPL Energy Supply's 2-5/8% Convertible Senior Notes due 2023 (Convertible Senior Notes), which were issued in May 2003, could be converted into shares of PPL common stock under certain circumstances, including if during a fiscal quarter the market price of PPL's common stock exceeded \$29.83 per share over a certain period during the preceding fiscal quarter or if PPL Energy Supply called the debt.

During 2008, all then-outstanding Convertible Senior Notes were either converted at the election of the holders or redeemed at par by PPL Energy Supply.

The terms of the Convertible Senior Notes required cash settlement of the principal amount and permitted settlement of any conversion premium in cash or PPL common stock. Based upon the conversion rate of 40.2212 shares per \$1,000 principal amount of notes (or \$24.8625 per share), the Convertible Senior Notes had a dilutive impact when the average market price of PPL common stock equaled or exceeded \$24.87.

During 2009, PPL issued 559,744 shares of common stock related to the exercise of stock options, vesting of restricted stock and restricted stock units and conversion of stock units granted to directors under its stock-based compensation plans. In addition, PPL issued 235,013 and 1,854,559 shares of common stock related to its ESOP and its DRIP. See Note 11 for a discussion of PPL's stock-based compensation plans.

The following stock options to purchase PPL common stock and performance units were excluded in the periods' computations of diluted EPS because the effect would have been antidilutive.

<i>(Thousands of Shares)</i>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Stock options and performance units	2,395	606	

**5. Income and Other Taxes**

*(PPL)*

"Income from Continuing Operations Before Income Taxes" included the following components:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Domestic income	\$ 306	\$ 1,027	\$ 1,021
Foreign income	290	330	260
	<u>\$ 596</u>	<u>\$ 1,357</u>	<u>\$ 1,281</u>

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for accounting purposes and their basis for income tax purposes and the tax effects of net operating loss and tax credit carryforwards.

Net deferred tax assets have been recognized based on management's estimates of future taxable income for U.S. and certain foreign jurisdictions in which PPL's operations have historically been profitable.

Significant components of PPL's deferred income tax assets and liabilities from continuing operations were as follows:

	<u>2009</u>	<u>2008</u>
<b>Deferred Tax Assets</b>		
Deferred investment tax credits	\$ 16	\$ 20
NUG contracts and buybacks	6	22
Regulatory liabilities	28	
Accrued pension costs	265	241
State loss carryforwards	184	159
Federal tax credit carryforwards	23	23

Foreign capital loss carryforwards	144	126
Foreign - pensions	168	87
Foreign - other	6	9
Contributions in aid of construction	98	79
Domestic - other	189	192
Valuation allowances	(312)	(285)
	<u>815</u>	<u>673</u>

#### Deferred Tax Liabilities

Plant - net	1,855	1,467
Recoverable transition costs		116
Taxes recoverable through future rates	104	103
Unrealized gains on qualifying derivatives	437	72
Foreign investments	5	6
Reacquired debt costs	14	12
Foreign - plant	546	519
Foreign - other	35	67
Domestic - other	67	55
	<u>3,063</u>	<u>2,417</u>
<b>Net deferred tax liability</b>	<u>\$ 2,248</u>	<u>\$ 1,744</u>

PPL had federal foreign tax credit carryforwards that expire by 2019 of \$23 million at December 31, 2009 and 2008. PPL also had state net operating loss carryforwards that expire between 2010 and 2029 of \$2.8 billion and \$2.5 billion at December 31, 2009 and 2008. Valuation allowances have been established for the amount that, more likely than not, will not be realized.

PPL Global had no foreign net operating loss carryforwards at December 31, 2009 and 2008. PPL Global had foreign capital loss carryforwards of \$514 million and \$451 million at December 31, 2009 and 2008. All of these losses have an indefinite carryforward period. Valuation allowances have been established for the amount that, more likely than not, will not be realized. Of the total valuation allowances related to foreign capital loss carryforwards, \$63 million was previously allocable to goodwill; however, upon adoption of new business combination guidance, effective January 1, 2009, all changes in valuation allowances associated with business combinations are now recognized in tax expense rather than in goodwill. See Note 1 for additional information.

The changes in deferred tax valuation allowances were :

	Balance at Beginning of Period	Additions		Deductions	Balance at End of Period
		Charged to Income	Charged to Other Accounts		
2009	\$ 285	\$ 24	\$ 17 (a)	\$ 14 (b)	\$ 312
2008 (c)	323	9		47 (a)	285
2007 (c)	352	2		31 (d)	323

- (a) Related to the change in foreign net operating loss carryforwards, including the change in foreign currency exchange rates.  
(b) Resulting from the projected revenue increase in connection with the expiration of the generation rate caps in 2010, the valuation allowance related to state net operating loss carryforwards was reduced by \$13 million.  
(c) Pennsylvania state legislation, enacted in 2007 and 2009, increased the net operating loss limitation. As a result, the deferred tax asset (and related valuation allowance) associated with certain of its Pennsylvania net operating loss carryforwards for all periods presented were increased to reflect the higher limitation. There was no impact on the net deferred tax asset position as a result of the legislation and related adjustments.  
(d) Primarily related to the change in domestic net operating loss carryforwards.

PPL Global does not pay or record U.S. income taxes on the undistributed earnings of WPD as management has determined that the earnings are permanently reinvested. Historically, dividends paid by WPD have been distributions of the current year's earnings. WPD's long-term working capital forecasts and capital expenditure projections for the foreseeable future require reinvestment of WPD's undistributed earnings and WPD would have to issue debt or access credit facilities to fund any distributions in excess of current earnings. Additionally, U.S. long-term working capital forecasts and capital expenditure projections for the foreseeable future do not require or anticipate WPD distributing any more than future earnings to its parent in the U.S. The cumulative undistributed earnings are included in "Earnings reinvested" on the Balance Sheets. The amounts considered permanently reinvested at December 31, 2009 and 2008 were \$622 million and \$1.2 billion. If the earnings are remitted as dividends, PPL Global may be subject to additional U.S. taxes, net of allowable foreign tax credits. It is not practicable to estimate the amount of additional taxes that might be payable on these foreign earnings.

Details of the components of income tax expense, a reconciliation of federal income taxes derived from statutory tax rates applied to "Income on Continuing Operations Before Income Taxes" to income taxes for reporting purposes, and details of "Taxes, other than income" were:

	2009	2008	2007
<b>Income Tax Expense</b>			
Current - Federal	\$ (59)	\$ 237	\$ 181

Current - State	21	9	9
Current - Foreign	41	70	83
	<u>3</u>	<u>316</u>	<u>273</u>
Deferred - Federal	135	72	32
Deferred - State (a)	(10)	43	20
Deferred - Foreign (b)	16	13	(52)
	<u>141</u>	<u>128</u>	<u></u>
Investment tax credit, net - Federal	(14)	(14)	(14)
Total income tax expense from continuing operations (c)	<u>\$ 130</u>	<u>\$ 430</u>	<u>\$ 259</u>
Total income tax expense - Federal	\$ 62	\$ 295	\$ 199
Total income tax expense - State	11	52	29
Total income tax expense - Foreign	57	83	31
Total income tax expense from continuing operations (c)	<u>\$ 130</u>	<u>\$ 430</u>	<u>\$ 259</u>

- (a) Includes a \$13 million reduction to state deferred tax expense related to the reversal of deferred tax valuation allowances. See "Reconciliation of Income Tax Expense" for additional information.
- (b) Includes a \$54 million deferred tax benefit recorded in 2007 related to the U.K. tax rate reduction effective April 1, 2008. See "Reconciliation of Income Tax Expense" for additional information.
- (c) Excludes current and deferred federal, state and foreign tax expense (benefit) recorded to Discontinued Operations of \$21 million in 2009 and \$154 million in 2007. Excludes realized tax benefits related to stock-based compensation, recorded as an increase to capital in excess of par value of \$1 million in 2009, \$7 million in 2008 and \$25 million in 2007. Also, excludes federal, state, and foreign tax expense (benefit) recorded to OCI of \$358 million in 2009, \$(212) million in 2008 and \$20 million in 2007.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>Reconciliation of Income Tax Expense</b>			
Federal income tax on Income from Continuing Operations			
Before Income Taxes at statutory tax rate - 35%	\$ 209	\$ 475	\$ 448
Increase (decrease) due to:			
State income taxes (a) (b)	40	47	29
State net operating loss valuation allowance (c)	(13)		
Amortization of investment tax credits	(10)	(10)	(10)
Difference related to income recognition of foreign affiliates (net of foreign income taxes) (d)	(93)	(48)	(39)
Enactment of the U.K.'s Finance Act 2008 and 2007 (e)		(8)	(54)
Change in federal tax reserves (a)	6	10	(27)
Change in foreign tax reserves (a) (d)	17	5	
Stranded cost securitization (a)	(6)	(7)	(7)
Federal income tax return adjustments (b)	(10)	(6)	(8)
Foreign income tax return adjustments (b)		(17)	(2)
Federal income tax credits (b)	(2)	15	(57)
Domestic manufacturing deduction	(3)	(17)	(15)
Other	(5)	(9)	1
	<u>(79)</u>	<u>(45)</u>	<u>(189)</u>
<b>Total income tax expense</b>	<u>\$ 130</u>	<u>\$ 430</u>	<u>\$ 259</u>
<b>Effective income tax rate</b>	21.8%	31.7%	20.2%

- (a) Changes in income tax reserves impacted the following components of income tax expense, which are presented in the "Reconciliation of Income Tax Expense" table.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Change in foreign tax reserves	\$ 17	\$ 5	
Change in federal tax reserves (f)	6	10	\$ (27)
Stranded cost securitization	(6)	(7)	(7)
State income taxes (f)	(5)	3	1
	<u>\$ 12</u>	<u>\$ 11</u>	<u>\$ (33)</u>

- (b) Adjustments from filing prior year tax returns impacted the following components of income tax expense, which are presented in the "Reconciliation of Income Tax Expense" table.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
State income taxes (f)	\$ 31	\$ 4	\$ (1)
Federal income tax return adjustments (f)	(10)	(6)	(8)
Foreign income tax return adjustments		(17)	(2)
Federal income tax credits (g)		16	



\$ 21    \$ (3)    \$ (11)

(c) Pennsylvania H.B. 1531, enacted in October 2009, increased the net operating loss limitation to 20% of taxable income for tax years beginning in 2010. In conjunction with the projected revenue increase related to the expiration of the generation rate caps in 2010, PPL recorded a \$13 million reduction to state deferred income tax expense related to the reversal of deferred tax valuation allowances for a portion of its Pennsylvania net operating losses.

(d) Income tax (benefits) related to foreign income, which are presented in the "Reconciliation of Income Tax Expense" table.

	<b>2009</b>	<b>2008</b>	<b>2007</b>
Losses generated through restructuring and fully reserved (reflected in "Change in foreign tax reserves")	\$ (46)		
Impact of lower U.K. income tax rates	(23)	\$ (22)	\$ (16)
U.S. income tax on foreign earnings - net of foreign tax credit	(16)	(21)	(14)
Other	(8)	(5)	(9)
	\$ (93)	\$ (48)	\$ (39)

(e) The U.K.'s Finance Act 2008, enacted in July 2008, included a phase-out of tax depreciation on certain buildings. As a result, PPL recorded an \$8 million deferred tax benefit during 2008 related to the reduction in its deferred tax liabilities.

The U.K.'s Finance Act of 2007, enacted in July 2007, included a reduction in the U.K.'s statutory income tax rate. Effective April 1, 2008, the statutory income tax rate was reduced from 30% to 28%. As a result, PPL recorded a \$54 million deferred tax benefit during 2007 related to the reduction in its deferred tax liabilities.

(f) During 2009, PPL received consent from the IRS to change its method of accounting for certain expenditures for tax purposes. PPL deducted the resulting IRC Sec. 481 adjustment on its 2008 federal income tax return and recorded a \$24 million adjustment to federal and state income tax expense resulting from the reduction of federal income tax benefits related to the domestic manufacturing deduction and reduction of certain state tax benefits related to state net operating losses and regulated depreciation. The \$24 million of income tax expense consisted of \$29 million expense reflected in "State income taxes," offset by \$4 million benefit reflected in "Federal income tax return adjustments" and a \$1 million benefit reflected in "Change in federal tax reserves."

(g) During March 2008, PPL Energy Supply recorded a \$13 million expense to adjust the amount of synthetic fuel tax credits recorded during 2007. See Note 14 for additional information.

	<b>2009</b>	<b>2008</b>	<b>2007</b>
<b>Taxes, other than income</b>			
State gross receipts	\$ 187	\$ 199	\$ 193
State utility realty	5	4	5
State capital stock	6	5	8
Property - foreign	57	66	67
Domestic property and other	25	14	25
	\$ 280	\$ 288	\$ 298

See Note 1 for information on a settlement related to PURTA tax that will be returned to PPL Electric customers.

For tax years 2000 through 2007, PPL Montana protested certain property tax assessments by the Montana Department of Revenue on its generation facilities. The tax liabilities in dispute for 2000 through 2007, which had been paid and expensed by PPL Montana, totaled \$45 million. In January 2008, both parties reached a settlement for all years outstanding. The settlement resulted in PPL Montana receiving a refund of taxes paid and interest totaling \$8 million. This settlement was recorded in 2008, of which \$7 million was reflected in "Taxes, other than income" and \$1 million was reflected in "Other Income - net" on the Statement of Income.

*(PPL Energy Supply)*

"Income from Continuing Operations Before Income Taxes" included the following components:

	<b>2009</b>	<b>2008</b>	<b>2007</b>
Domestic income	\$ 44	\$ 755	\$ 835
Foreign income	290	330	260
	\$ 334	\$ 1,085	\$ 1,095

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for accounting purposes and their basis for income tax purposes and the tax effects of net operating loss and tax credit carryforwards.

Net deferred tax assets have been recognized based on management's estimates of future taxable income for U.S. and certain foreign jurisdictions in which PPL's operations have historically been profitable.

Significant components of PPL Energy Supply's deferred income tax assets and liabilities from continuing operations were as follows:

	<u>2009</u>	<u>2008</u>
<b>Deferred Tax Assets</b>		
Deferred investment tax credits	\$ 12	\$ 16
NUG contracts and buybacks	6	22
Accrued pension costs	149	135
Federal tax credit carryforwards	23	23
Foreign capital loss carryforwards	144	126
Foreign - pensions	168	87
Foreign - other	6	9
Other domestic	100	98
Valuation allowances	(144)	(127)
	<u>464</u>	<u>389</u>
<b>Deferred Tax Liabilities</b>		
Plant - net	1,046	796
Unrealized gain on qualifying derivatives	417	81
Foreign investments	5	6
Foreign - plant	546	519
Foreign - other	35	67
Other domestic	41	33
	<u>2,090</u>	<u>1,502</u>
<b>Net deferred tax liability</b>	<u>\$ 1,626</u>	<u>\$ 1,113</u>

PPL Energy Supply had federal foreign tax credit carryforwards that expire by 2019 of \$23 million at December 31, 2009 and 2008. PPL Energy Supply also had state net operating loss carryforwards that expire between 2010 and 2029 of \$9 million at December 31, 2009 and 2008. Valuation allowances have been established for the amount that, more likely than not, will not be realized.

PPL Global had no foreign net operating loss carryforwards at December 31, 2009 and December 31, 2008. PPL Global had foreign capital loss carryforwards of \$514 million and \$451 million at December 31, 2009 and 2008. All of these losses have an indefinite carryforward period. Valuation allowances have been established for the amount that, more likely than not, will not be realized. Of the total valuation allowances related to foreign capital loss carryforwards, \$63 million was allocable to goodwill; however, upon adoption of new business combination guidance, effective January 1, 2009, all changes in valuation allowances associated with business combinations will be recognized in tax expense rather than in goodwill. See Note 1 for additional information.

Changes in deferred tax valuation allowances were :

	<u>Balance at</u>	<u>Additions</u>		<u>Deductions</u>	<u>Balance at End</u>
	<u>Beginning of Period</u>	<u>Charged to Income</u>	<u>Charged to Other</u>		<u>of Period</u>
			<u>Accounts</u>		
2009	\$ 127		\$ 17(a)		\$ 144
2008	174			\$ 47 (a)	127
2007	178	\$ 2		6	174

(a) Primarily related to the change in foreign net operating loss carryforwards including the change in foreign currency exchange rates.

PPL Global does not pay or record U.S. income taxes on the undistributed earnings of WPD as management has determined that the earnings are permanently reinvested. Historically, dividends paid by WPD have been distributions of the current year's earnings. WPD's long-term working capital forecasts and capital expenditure projections for the foreseeable future require reinvestment of WPD's undistributed earnings and WPD would have to issue debt or access credit facilities to fund any distributions in excess of current earnings. Additionally, U.S. long-term working capital forecasts and capital expenditure projections for the foreseeable future do not require or anticipate WPD distributing any more than future earnings to its parent in the U.S. The cumulative undistributed earnings are included in "Members Equity" on the Balance Sheets. The amounts considered permanently reinvested at December 31, 2009 and 2008 were \$622 million and \$1.2 billion. If the earnings are remitted as dividends, PPL Global may be subject to additional U.S. taxes, net of allowable foreign tax credits. It is not practicable to estimate the amount of additional taxes that might be payable on these foreign earnings.

Details of the components of income tax expense, a reconciliation of federal income taxes derived from statutory tax rates applied to "Income from Continuing Operations Before Income Taxes" to income taxes for reporting purposes, and details of "Taxes, other than income" were:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>Income Tax Expense</b>			
Current - Federal	\$ (155)	\$ 61	\$ 13
Current - State	(3)	10	28

Current - Foreign	41	70	83
	<u>(117)</u>	<u>141</u>	<u>124</u>
Deferred - Federal	128	144	121
Deferred - State	32	49	25
Deferred - Foreign (a)	16	13	(52)
	<u>176</u>	<u>206</u>	<u>94</u>
Investment tax credit, net - Federal	(12)	(12)	(12)
Total income tax expense from continuing operations (b)	<u>\$ 47</u>	<u>\$ 335</u>	<u>\$ 206</u>
Total income tax expense - Federal	\$ (39)	\$ 193	\$ 122
Total income tax expense - State	29	59	53
Total income tax expense - Foreign	57	83	31
Total income tax expense from continuing operations (b)	<u>\$ 47</u>	<u>\$ 335</u>	<u>\$ 206</u>

- (a) Includes a \$54 million deferred tax benefit recorded in 2007 related to the U.K. tax rate reduction effective April 1, 2008. See "Reconciliation of Income Tax Expense" for additional information.
- (b) Excludes current and deferred federal, state and foreign tax expense recorded to Discontinued Operations of \$22 million in 2009, \$1 million in 2008 and \$121 million in 2007. Also, excludes federal, state and foreign tax expense (benefit) recorded to OCI of \$338 million in 2009, \$(168) million in 2008 and \$19 million in 2007.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>Reconciliation of Income Tax Expense</b>			
Federal income tax on Income from Continuing Operations Before Income Taxes at statutory tax rate - 35%	\$ 117	\$ 380	\$ 383
Increase (decrease) due to:			
State income taxes (a) (b)	27	40	36
Amortization of investment tax credits	(8)	(8)	(8)
Difference related to income recognition of foreign affiliates (net of foreign income taxes) (c)	(93)	(48)	(39)
Enactment of the U.K.'s Finance Act 2008 and 2007 (d)		(8)	(54)
Change in federal tax reserves (a)		11	(28)
Change in foreign tax reserves (a) (c)	17	5	
Federal income tax return adjustments (b)	(7)	(11)	(10)
Foreign income tax return adjustments (b)		(17)	(2)
Federal income tax credits (b)	(2)	15	(57)
Domestic manufacturing deduction	(3)	(17)	(15)
Other	(1)	(7)	
	<u>(70)</u>	<u>(45)</u>	<u>(177)</u>
<b>Total income tax expense</b>	<u>\$ 47</u>	<u>\$ 335</u>	<u>\$ 206</u>
<b>Effective income tax rate</b>	14.1%	30.9%	18.8%

- (a) Changes in income tax reserves impacted the following components of income tax expense, which are presented in the "Reconciliation of Income Tax Expense" table.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Change in foreign tax reserves	\$ 17	\$ 5	
State income taxes	(3)		
Change in federal tax reserves		11	\$ (28)
	<u>\$ 14</u>	<u>\$ 16</u>	<u>\$ (28)</u>

- (b) Adjustments from filing prior year tax returns impacted the following components of income tax expense, which are presented in the "Reconciliation of Income Tax Expense" table.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
State income taxes (e)	\$ 25	\$ 2	\$ 2
Federal income tax return adjustments (e)	(7)	(11)	(10)
Foreign income tax return adjustments		(17)	(2)
Federal income tax credits (f)		16	
	<u>\$ 18</u>	<u>\$ (10)</u>	<u>\$ (10)</u>

- (c) Income tax (benefits) related to foreign income, which are presented in the "Reconciliation of Income Tax Expense" table.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Losses generated through restructuring and fully reserved (reflected			

in "Change in foreign tax reserves")	\$	(46)			
Impact of lower U.K. income tax rates		(23)	\$	(22)	\$
U.S. income tax on foreign earnings - net of foreign tax credit		(16)		(21)	
Other		(8)		(5)	
	\$	<u>(93)</u>	\$	<u>(48)</u>	\$
					<u>(39)</u>

(d) The U.K.'s Finance Act 2008, enacted in July 2008, included a phase-out of tax depreciation on certain buildings. As a result, PPL Energy Supply recorded an \$8 million deferred tax benefit during 2008 related to the reduction in its deferred tax liabilities.

The U.K.'s Finance Act of 2007, enacted in July 2007, included a reduction in the U.K.'s statutory income tax rate. Effective April 1, 2008, the statutory income tax rate was reduced from 30% to 28%. As a result, PPL recorded a \$54 million deferred tax benefit during 2007 related to the reduction in its deferred tax liabilities.

(e) During 2009, PPL Energy Supply received consent from the IRS to change its method of accounting for certain expenditures for tax purposes. PPL Energy Supply deducted the resulting IRC Sec. 481 adjustment on its 2008 federal income tax return and recorded a \$21 million reduction in federal income tax benefits related to the domestic manufacturing deduction and certain state tax benefits related to state net operating losses. The \$21 million income tax expense consisted of \$24 million expense reflected in "State income taxes," offset by \$2 million benefit reflected in "Federal income tax return adjustments" and a \$1 million benefit reflected in "Change in federal tax reserves."

(f) During March 2008, PPL Energy Supply recorded a \$13 million expense to adjust the amount of synthetic fuel tax credits recorded during 2007. See Note 14 for additional information.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>Taxes, other than income</b>			
State capital stock	\$ 3	\$ 3	\$ 5
Property - foreign	57	66	67
Domestic property and other	26	17	26
	<u>\$ 86</u>	<u>\$ 86</u>	<u>\$ 98</u>

For tax years 2000 through 2007, PPL Montana protested certain property tax assessments by the Montana Department of Revenue on its generation facilities. The tax liabilities in dispute for 2000 through 2007, which had been paid and expensed by PPL Montana, totaled \$45 million. In January 2008, both parties reached a settlement for all years outstanding. The settlement resulted in PPL Montana receiving a fund of taxes paid and interest totaling \$8 million. This settlement was recorded in 2008, of which \$7 million was reflected in "Taxes, other than income" and \$1 million was reflected in "Other Income - net" on the Statement of Income.

*(PPL Electric)*

The provision for PPL Electric's deferred income taxes for regulated assets is based upon the ratemaking principles reflected in rates established by the PUC and the FERC. The difference in the provision for deferred income taxes for regulated assets and the amount that otherwise would be recorded under GAAP is deferred and included in "Taxes recoverable through future rates" on the Balance Sheets.

The tax effects of significant temporary differences comprising PPL Electric's net deferred income tax liability were as follows:

	<u>2009</u>	<u>2008</u>
<b>Deferred Tax Assets</b>		
Deferred investment tax credits	\$ 3	\$ 4
Accrued pension costs	36	37
Contributions in aid of construction	99	79
Regulatory liabilities	28	
Other	39	43
	<u>205</u>	<u>163</u>
<b>Deferred Tax Liabilities</b>		
Electric utility plant - net	802	667
Recoverable transition costs		116
Taxes recoverable through future rates	105	104
Reacquired debt costs	14	11
Other	23	20
	<u>944</u>	<u>918</u>
<b>Net deferred tax liability</b>	<u>\$ 739</u>	<u>\$ 755</u>

Details of the components of income tax expense, a reconciliation of federal income taxes derived from statutory tax rates applied to "Income Before Income Taxes" to income taxes for reporting purposes, and details of "Taxes, other than income" were:

<u>2009</u>	<u>2008</u>	<u>2007</u>
-------------	-------------	-------------

<b>Income Tax Expense</b>			
Current - Federal	\$ 80	\$ 93	\$ 72
Current - State	22	8	(7)
	<u>102</u>	<u>101</u>	<u>65</u>
Deferred - Federal	(4)	10	24
Deferred - State	(17)	(7)	(4)
	<u>(21)</u>	<u>3</u>	<u>20</u>
Investment tax credit, net - Federal	(2)	(2)	(2)
Total income tax expense	<u>\$ 79</u>	<u>\$ 102</u>	<u>\$ 83</u>
Total income tax expense - Federal	\$ 74	\$ 101	\$ 94
Total income tax expense - State	5	1	(11)
Total income tax expense	<u>\$ 79</u>	<u>\$ 102</u>	<u>\$ 83</u>
<b>Reconciliation of Income Tax Expense</b>			
Federal income tax on Income Before Income Taxes at statutory tax rate - 35%	\$ 77	\$ 97	\$ 86
Increase (decrease) due to:			
State income taxes (a) (b)	15	13	2
Amortization of investment tax credit	(2)	(2)	(2)
Stranded cost securitization (a)	(6)	(7)	(7)
Other (a) (b)	(5)	1	4
	<u>2</u>	<u>5</u>	<u>(3)</u>
Total income tax expense	<u>\$ 79</u>	<u>\$ 102</u>	<u>\$ 83</u>
Effective income tax rate	35.7%	36.7%	33.7%

(a) Changes in income tax reserves impacted the following components of income tax expense, which are presented in the "Reconciliation of Income Tax Expense" table.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Stranded cost securitization	\$ (6)	\$ (7)	\$ (7)
State income taxes		2	1
Other	(1)		2
	<u>\$ (7)</u>	<u>\$ (5)</u>	<u>\$ (4)</u>

(b) Adjustments from filing prior year tax returns impacted the following components of income tax expense, which are presented in the "Reconciliation of Income Tax Expense" table.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
State income taxes (c)	\$ 5	\$ 2	\$ (4)
Other (c)	(1)	4	3
	<u>\$ 4</u>	<u>\$ 6</u>	<u>\$ (1)</u>

(c) During 2009, PPL Electric received consent from the IRS to change its method of accounting for certain expenditures for tax purposes. PPL Electric deducted the resulting IRC Sec. 481 amount on its 2008 federal income tax return and recorded a \$3 million adjustment to federal and state income tax expense resulting from the reversal of prior years' state income tax benefits related to regulated depreciation. The \$3 million income tax expense consisted of \$5 million expense reflected in "State income taxes" offset by a \$2 million federal benefit reflected in "Other".

	<u>2009</u>	<u>2008</u>	<u>2007</u>
<b>Taxes, other than income</b>			
State gross receipts	\$ 187	\$ 199	\$ 193
State utility realty	5	4	5
State capital stock	2	2	3
Property and other		(2)	(1)
	<u>\$ 194</u>	<u>\$ 203</u>	<u>\$ 200</u>

See Note 1 for information on a settlement related to PURTA tax that will be returned to PPL Electric customers.

**Unrecognized Tax Benefits (PPL, PPL Energy Supply and PPL Electric)**

Changes to unrecognized tax benefits were as follows:

	<u>2009</u>	<u>2008</u>
<b><u>PPL</u></b>		
Beginning of period	\$ 202	\$ 204
Additions based on tax positions of prior years	36	38
Reduction based on tax positions of prior years	(11)	(13)
Additions based on tax positions related to the current year	50	12
Settlements	(55)	(12)
Lapse of applicable statutes of limitations	(8)	(8)
Effects of foreign currency translation	(2)	(19)
End of period	<u>\$ 212</u>	<u>\$ 202</u>
<b><u>PPL Energy Supply</u></b>		
Beginning of period	\$ 119	\$ 130
Additions based on tax positions of prior years	17	21
Reduction based on tax positions of prior years	(5)	(10)
Additions based on tax positions related to the current year	50	9
Settlements	(55)	(12)
Lapse of applicable statutes of limitations		
Effects of foreign currency translation	(2)	(19)
End of period	<u>\$ 124</u>	<u>\$ 119</u>
<b><u>PPL Electric</u></b>		
Beginning of period	\$ 77	\$ 68
Additions based on tax positions of prior years	11	17
Reduction based on tax positions of prior years	(6)	(3)
Additions based on tax positions related to the current year		3
Lapse of applicable statutes of limitations	(8)	(8)
End of period	<u>\$ 74</u>	<u>\$ 77</u>

At December 31, 2009, it was reasonably possible that during the next 12 months the total amount of unrecognized tax benefits could increase by as much as \$34 million or decrease by up to \$179 million for PPL, increase by as much as \$11 million or decrease by up to \$123 million for PPL Energy Supply and increase by as much as \$23 million or decrease by up to \$22 million for PPL Electric. These changes could result from subsequent recognition, derecognition and/or changes in the measurement of uncertain tax positions related to the creditability of foreign taxes, the timing and utilization of foreign tax credits and the related impact on alternative minimum tax and other credits, the timing and/or valuation of certain deductions, intercompany transactions and unitary filing groups. The events that could cause these changes are direct settlements with taxing authorities, litigation, legal or administrative guidance by relevant taxing authorities and the lapse of an applicable statute of limitation.

At December 31, the total unrecognized tax benefits and related indirect effects that, if recognized, would decrease the effective tax rate were:

	<u>2009</u>	<u>2008</u>
PPL	\$ 119	\$ 129
PPL Energy Supply	95	103
PPL Electric	15	21

At December 31, 2009, PPL, PPL Energy Supply and PPL Electric had accrued interest related to tax positions of \$36 million, \$27 million and \$5 million. At December 31, 2008, PPL, PPL Energy Supply and PPL Electric had accrued interest of \$35 million, \$28 million and \$7 million.

PPL and its subsidiaries recognize interest and penalties in "Income Taxes" on their Statements of Income. The following expenses (benefits) were recognized at December 31:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
PPL	\$ 1	\$ 4	\$ (1)
PPL Energy Supply	(1)	2	(4)
PPL Electric	(2)	2	3

The amounts recognized during 2009, 2008 and 2007 for PPL, PPL Energy Supply and PPL Electric were primarily the result of additional interest accrued or reversed related to tax positions of prior years and the lapse of applicable statutes of limitations, with respect to certain issues.

PPL or its subsidiaries file tax returns in five major tax jurisdictions. PPL Energy Supply and PPL Electric's U.S. federal and state tax provision are calculated in accordance with an intercompany tax sharing policy with PPL, which provides that their taxable income be calculated as if PPL Energy Supply and its domestic subsidiaries and PPL Electric and its subsidiaries each filed a separate consolidated tax return. Based on this tax sharing policy, PPL Energy Supply or its subsidiaries indirectly or directly file tax returns in five major tax

jurisdictions and PPL Electric or its subsidiaries indirectly or directly file tax returns in two major tax jurisdictions. With few exceptions, at December 31, 2009, these jurisdictions, as well as the tax years that are no longer subject to examination, were as follows:

	<u>PPL and PPL Energy Supply</u>	<u>PPL Electric</u>
J.S. (federal)	1997 and prior	1997 and prior
Pennsylvania (state)	2004 and prior	2004 and prior
Montana (state)	2005 and prior	
U.K. (foreign)	2006 and prior	
Chile (foreign)	2006 and prior	

## 6. Preferred Securities

(PPL)

PPL is authorized to issue up to 10 million shares of preferred stock. No PPL preferred stock was issued or outstanding in 2009, 2008 or 2007.

(PPL and PPL Electric)

Details of PPL Electric's preferred securities (with no stated maturity date and no sinking fund requirements), which are reflected on PPL's Balance Sheets in "Noncontrolling Interests," as of December 31, 2009 and 2008, were:

	<u>Amount</u>	<u>Issued and Outstanding Shares</u>	<u>Shares Authorized</u>	<u>Optional Redemption Price Per Share at 12/31/09</u>
4-1/2% Preferred Stock (a)	\$ 25	247,524	629,936	\$ 110.00
Series Preferred Stock (a)				
3.35%	2	20,605		103.50
4.40%	12	117,676		102.00
4.60%	3	28,614		103.00
6.75%	9	90,770		101.35
Total Series Preferred Stock	<u>26</u>	<u>257,665</u>	10,000,000	
6.25% Series Preference Stock (a)				
(b)	<u>250</u>	<u>2,500,000</u>	10,000,000	(c)
Total Preferred Securities	<u>\$ 301</u>	<u>3,005,189</u>		

(a) In 2009, 2008 and 2007, there were no changes in the number of shares of Preferred Stock or Preference Stock outstanding.

(b) These shares were issued to a bank that acts as depositary in connection with the 2006 sale of 10 million depositary shares, each representing a quarter interest in a share of PPL Electric's 6.25% Series Preference Stock (Preference Shares).

(c) Redeemable by PPL Electric on or after April 6, 2011, for \$100 per share (equivalent to \$25 per depositary share).

Dividend requirements of \$18 million were included in "Net Income Attributable to Noncontrolling Interests" on PPL's Statements of Income for 2009, 2008 and 2007.

### Preferred Stock

The involuntary liquidation price of the preferred stock is \$100 per share. The optional voluntary liquidation price is the optional redemption price per share in effect, except for the 4-1/2% Preferred Stock and the 6.75% Series Preferred Stock for which such price is \$100 per share (plus, in each case, any unpaid dividends in arrears).

Dividends on the preferred stock are cumulative. Preferred stock ranks senior to PPL Electric's common stock and its Preference Shares.

Holders of the outstanding preferred stock are entitled to one vote per share on matters on which PPL Electric's shareowners are entitled to vote. However, if dividends on any preferred stock are in arrears in an amount equal to or greater than the annual dividend rate, the holders of the preferred stock are entitled to elect a majority of the Board of Directors of PPL Electric.

### Preference Stock

Holders of the depositary shares, each of which represents a quarter interest in a share of Preference Shares, are entitled to all proportional rights and preferences of the Preference Shares, including dividend, voting, redemption and liquidation rights, exercised through the bank acting as a depositary. The Preference Shares rank senior to PPL Electric's common stock and junior to its preferred stock; they have no voting rights, except as provided by law, and they have a liquidation preference of \$100 per share.

Dividends on the Preference Shares will be paid when, as and if declared by the Board of Directors at a fixed annual rate of 6.25%, or \$1.5625 per depositary share per year, and are not cumulative. PPL Electric may not pay dividends on, or redeem, purchase or make a liquidation payment with respect to any of its common stock, except in certain circumstances, unless full dividends on the Preference Shares have been paid for the then-current dividend period.

## 7. Financing Activities

### Credit Arrangements and Short-term Debt

(PPL and PPL Energy Supply)

PPL Energy Supply maintains credit facilities in order to enhance liquidity and provide credit support, and as a backstop to its commercial paper program, when necessary. PPL Energy Supply had the following credit facilities in place at:

	Expiration Date	December 31, 2009				December 31, 2008	
		Capacity	Borrowed (a)	Letters of Credit Issued	Unused Capacity	Borrowed (a)	Letters of Credit Issued
<i>PPL Energy Supply Domestic Credit Facilities (b)</i>							
364-day Bilateral Credit Facility (c)	Mar-10	\$ 200	n/a	\$ 4	\$ 196	n/a	\$ 96
364-day Syndicated Credit Facility (d)	Sept-10	400			400		
5-year Structured Credit Facility (e)	Mar-11	300	n/a	285	15	n/a	269
5-year Syndicated Credit Facility (f)	June-12	3,225	\$ 285	373	2,567	285	255
Total PPL Energy Supply Domestic Credit Facilities		\$ 4,125	\$ 285	\$ 662	\$ 3,178	285	\$ 620
<i>WPD Credit Facilities</i>							
WPDH Limited 5-year Syndicated Credit Facility (g)	Jan-13	£ 150	£ 132	n/a	£ 18	£ 121	n/a
WPD (South West) 3-year Syndicated Credit Facility (h)	July-12	210	60	n/a	150	37	n/a
WPD (South West) Uncommitted Credit Facilities (i)		65	21	n/a	44	8	n/a
WPD (South West) Letter of Credit Facility	Mar-10	4	n/a	£ 3	1	n/a	£ 4
Total WPD Credit Facilities (j)		£ 429	£ 213	£ 3	£ 213	£ 166	£ 4

(a) Amounts borrowed are recorded as "Short-term debt" on the Balance Sheets.

(b) These credit facilities contain a financial covenant requiring debt to total capitalization to not exceed 65%.

(c) In March 2009, PPL Energy Supply's 364-day bilateral credit facility was amended. The amendment included extending the expiration date from March 2009 to March 2010 and reducing the capacity from \$300 million to \$200 million. Under this facility, PPL Energy Supply can request the bank to issue letters of credit but cannot make cash borrowings.

(d) In September 2009, PPL Energy Supply's 364-day syndicated credit facility was amended and restated. The amendment included extending the expiration date from September 2009 to September 2010, increasing the capacity from \$385 million to \$400 million and limiting the amount of letters of credit that may be issued. Under this facility, PPL Energy Supply has the ability to make cash borrowings and to request the lenders to issue up to \$200 million of letters of credit. Borrowings generally bear interest at LIBOR-based rates plus a spread, depending upon the company's public debt rating.

(e) Under this facility, PPL Energy Supply has the ability to request the lenders to issue letters of credit but cannot make cash borrowings. PPL Energy Supply's obligations under this facility are supported by a \$300 million letter of credit issued on PPL Energy Supply's behalf under a separate, but related, \$300 million five-year credit agreement, also expiring in March 2011.

(f) Under this facility, PPL Energy Supply has the ability to make cash borrowings and to request the lenders to issue letters of credit. Borrowings generally bear interest at LIBOR-based rates plus a spread, depending upon the company's public debt rating. The interest rate on the borrowings outstanding was 0.73% and 2.70% at December 31, 2009 and 2008. Under certain conditions, PPL Energy Supply may elect to have the principal balance of the loans outstanding on the final expiration date of the facility continue as non-revolving term loans for a period of one year from that final expiration date. Also, under certain conditions, PPL Energy Supply may request that the facility's capacity be increased by up to \$500 million.

(g) Under this facility, WPDH Limited has the ability to make cash borrowings but cannot request the lenders to issue letters of credit. Borrowings under this facility bear interest at LIBOR-based rates plus a spread, depending on the company's public debt rating. The cash borrowings outstanding at December 31, 2009 were comprised of a USD-denominated borrowing of \$181 million, which equated to £107 million at the time of borrowing and bears interest at approximately 1.55%, and GBP-denominated borrowings in an aggregate of £25 million, which bear interest at a weighted-average rate of approximately 1.53%. The interest rates at December 31, 2008 were 3.73% on USD-denominated borrowings and 3.11% on GBP-denominated borrowings.



This credit facility contains financial covenants that require WPDH Limited to maintain an interest coverage ratio of not less than 3.0 times consolidated earnings before income taxes, depreciation and amortization and a RAB that exceeds total net debt by the higher of an amount equal to 15% of total net debt or £150 million, in each case as calculated in accordance with the credit facility.

- a) In July 2009, WPD (South West) terminated its £150 million five-year syndicated credit facility, which was to expire in October 2009, and replaced it with a new £210 million three-year syndicated credit facility expiring in July 2012. Under the new facility, WPD (South West) has the ability to make cash borrowings but cannot request the lenders to issue letters of credit. The new facility contains financial covenants that require WPD (South West) to maintain an interest coverage ratio of not less than 3.0 times consolidated earnings before income taxes, depreciation and amortization and total net debt not in excess of 85% of its RAB, in each case calculated in accordance with the credit facility.

Borrowings under this facility bear interest at LIBOR-based rates plus a margin. The borrowings outstanding at December 31, 2009 bear interest at a weighted-average rate of approximately 3.02%. The interest rate at December 31, 2008 on the borrowings outstanding under the previous facility was approximately 3.01%.

- (i) The weighted-average interest rate on the borrowings outstanding under these facilities was 1.22% and 2.77% at December 31, 2009 and 2008.
- (j) The total amount borrowed under WPD's credit facilities equated to approximately \$354 million and \$299 million at December 31, 2009 and 2008. At December 31, 2009, the unused capacity of the WPD credit facilities was approximately \$349 million.

During 2008, PPL Energy Supply maintained a commercial paper program for up to \$500 million, under which commercial paper issuances were supported by its credit facilities, to provide an additional financing source to fund its short-term liquidity needs, if and when necessary. PPL Energy Supply had no commercial paper outstanding at December 31, 2008. In January 2009, PPL Energy Supply closed its commercial paper program.

*(PPL and PPL Electric)*

PPL Electric maintains credit facilities in order to enhance liquidity and provide credit support, and as a backstop to its commercial paper program. PPL Electric had the following credit facilities in place at:

	Expiration Date	December 31, 2009			December 31, 2008		
		Capacity	Borrowed (a)	Letters of Credit Issued	Unused Capacity	Borrowed (a)	Letters of Credit Issued
5-year Syndicated Credit Facility (b)	May-12	\$ 190		\$ 6	\$ 184	\$ 95	\$ 1
Asset-backed Credit Facility (c)	Jul-10	150			150		
Total PPL Electric Credit Facilities		<u>\$ 340</u>		<u>\$ 6</u>	<u>\$ 334</u>	<u>\$ 95</u>	<u>\$ 1</u>

- (a) Amounts borrowed are recorded as "Short-term debt" on the Balance Sheets.
- (b) Under this facility, PPL Electric has the ability to make cash borrowings and to request the lenders to issue letters of credit. Borrowings generally bear interest at LIBOR-based rates plus a spread, depending upon the company's public debt rating. The interest rate on the borrowings outstanding at December 31, 2008 was 2.44%. Under certain conditions, PPL Electric may elect to have the principal balance of the loans outstanding on the final expiration date of the facility continue as non-revolving term loans for a period of one year from that final expiration date. Also, under certain conditions, PPL Electric may request that the facility's capacity be increased by up to \$100 million.

This credit facility contains a financial covenant requiring debt to total capitalization to not exceed 70%.

- (c) PPL Electric participates in an asset-backed commercial paper program through which PPL Electric obtains financing by selling and contributing its eligible accounts receivable and unbilled revenue to a special purpose, wholly owned subsidiary on an ongoing basis. The subsidiary has pledged these assets to secure loans from a commercial paper conduit sponsored by a financial institution. In July 2009, PPL Electric and the subsidiary extended the expiration date of the credit agreement to July 2010. The subsidiary's borrowing costs under the credit facility vary based on the commercial paper conduit's actual cost to issue commercial paper that supports the debt. Borrowings under this program are subject to customary conditions precedent. PPL Electric uses the proceeds under the credit facility for general corporate purposes.

At December 31, 2009 and 2008, \$223 million and \$76 million of accounts receivable and \$192 million and \$170 million of unbilled revenue were pledged by the subsidiary under the credit agreement related to PPL Electric's and the subsidiary's participation in the asset-backed commercial paper program. Based on the accounts receivable and unbilled revenue pledged, \$150 million was available for borrowing at December 31, 2009. PPL Electric's sale to its subsidiary of the accounts receivable and unbilled revenue is an absolute sale of the assets, and PPL Electric does not retain an interest in these assets. However, for financial reporting purposes, the subsidiary's financial results are consolidated in PPL Electric's financial statements. PPL Electric performs certain record-keeping and cash collection functions with respect to the assets in return for a servicing fee from the subsidiary.

PPL Electric maintains a commercial paper program for up to \$200 million to provide an additional financing source to fund its short-term liquidity needs, if and when necessary. Commercial paper issuances are supported by PPL Electric's five-year syndicated credit facility that expires in May 2012 based on available capacity. PPL Electric had no commercial paper outstanding at December 31, 2009 and 2008.

#### Long-term Debt

U.S.	2009 (a)			2008		
	PPL	PPL Energy Supply	PPL Electric	PPL	PPL Energy Supply	PPL Electric
4.33% - 7.0% Senior Unsecured Notes, due 2009-2047 (b)	\$ 2,700(c)	\$ 2,600		\$ 3,151	\$ 2,850	
Junior Subordinated Notes, due 2067 (d)	500			500		
8.05% - 8.30% Senior Secured Notes, due 2013 (e)	437	437		437	437	
7.375% 1945 First Mortgage Bonds, due 2014 (f)	10		\$ 10	10		\$ 10
4.30% - 7.125% Senior Secured Bonds, due 2009-2039 (g)	1,150		1,150	1,436		1,436
4.70% - 4.75% Senior Secured Bonds (Pollution Control Series), due 2027-2029 (h)(i)	224		224	224		224
Variable Rate Senior Secured Bonds (Pollution Control Series), due 2023 (h)(j)	90		90	90		90
Variable Rate Exempt Facilities Notes, due 2037-2038 (k)	231	231		231	231	
Variable Rate Pollution Control Facilities Note, due 2027 (l)				9		9
	<u>5,342</u>	<u>3,268</u>	<u>1,474</u>	<u>6,088</u>	<u>3,518</u>	<u>1,769</u>
<b>U.K.</b>						
4.80436% - 9.25% Senior Unsecured Notes, due 2017-2037 (m)	1,327	1,327		1,261	1,261	
1.541% Index-linked Senior Unsecured Notes, due 2053-2056 (n)	397	397		377	377	
	<u>1,724</u>	<u>1,724</u>		<u>1,638</u>	<u>1,638</u>	
	7,066	4,992	1,474	7,726	5,156	1,769
Fair value adjustments from hedging activities	44	3		80	5	
Fair value adjustments from purchase accounting (o)	35	35		35	35	
Unamortized premium	9	9		10	10	
Unamortized discount	(11)	(8)	(2)	(13)	(10)	
	<u>7,143</u>	<u>5,031</u>	<u>1,472</u>	<u>7,838</u>	<u>5,196</u>	<u>1,769</u>
Less amount due within one year				(696)		(495)
Total Long-term Debt	<u>\$ 7,143</u>	<u>\$ 5,031</u>	<u>\$ 1,472</u>	<u>\$ 7,142</u>	<u>\$ 5,196</u>	<u>\$ 1,274</u>

(a) Aggregate maturities of long-term debt are:

PPL - 2010, \$0; 2011, \$500; 2012, \$0; 2013, \$1,137; 2014, \$310; and \$5,119 thereafter.

PPL Energy Supply - 2010, \$0; 2011, \$500; 2012, \$0; 2013, \$737; 2014, \$300; and \$3,455 thereafter.

PPL Electric - 2010, 2011 and 2012, \$0; 2013, \$400; 2014, \$10; and \$1,064 thereafter.

None of the debt securities outstanding have sinking fund requirements.

(b) Includes \$300 million of 5.70% REset Put Securities due 2035 (REPS<sup>SM</sup>). The REPS bear interest at a rate of 5.70% per annum to, but excluding, October 15, 2015 (Remarketing Date). The REPS are required to be put by existing holders on the Remarketing Date either for (a) purchase and remarketing by a designated remarketing dealer or (b) repurchase by PPL Energy Supply. If the remarketing dealer elects to purchase the REPS for remarketing, it will purchase the REPS at 100% of the principal amount, and the REPS will bear interest on and after the Remarketing Date at a new fixed rate per annum determined in the remarketing. PPL Energy Supply has the right to terminate the remarketing process. If the remarketing is terminated at the option of PPL Energy Supply or under certain other circumstances, including the occurrence of an event of default by PPL Energy Supply under the related indenture or a failed remarketing for certain specified reasons, PPL Energy Supply will be required to pay the remarketing dealer a settlement amount as calculated in accordance with the related remarketing agreement.

Also includes \$250 million of notes that may be redeemed at par beginning in July 2011.

In March 2009, PPL Energy Supply completed tender offers to purchase up to \$250 million aggregate principal amount of certain of its outstanding senior notes in order to reduce future interest expense. Pursuant to the offers, PPL Energy Supply purchased approximately \$100 million aggregate principal amount of its 6.00% Senior Notes due 2036 for \$77 million, plus accrued interest, and approximately \$150 million aggregate principal amount of its 6.20% Senior Notes due 2016 for \$143 million, plus accrued interest. In connection with the extinguishment of these notes, PPL and PPL Energy Supply recorded a net gain of \$25 million, which is reflected in "Other Income -

net" on the Statement of Income for 2009. PPL recorded an additional net gain of \$4 million in "Other Income - net" on the Statement of Income as a result of reclassifying gains and losses on related cash flow hedges from AOCI into earnings.

- (c) Includes \$100 million of notes that may be redeemed at par beginning in July 2012.

In March 2009, PPL Capital Funding retired the entire \$201 million of its 4.33% Notes Exchange Series A upon maturity.

- (d) The notes bear interest at 6.70% into March 2017, at which time the notes will bear interest at three-month LIBOR plus 2.665%, reset quarterly, until maturity. Interest payments may be deferred, from time to time, on one or more occasions for up to ten consecutive years. The notes may be redeemed at par beginning in March 2017. In connection with the issuance of the notes, PPL and PPL Capital Funding entered into a Replacement Capital Covenant, in which PPL and PPL Capital Funding agreed for the benefit of holders of a designated series of unsecured long-term indebtedness of PPL or PPL Capital Funding ranking senior to the notes that (i) PPL Capital Funding will not redeem or purchase the notes, or otherwise satisfy, discharge or defease the principal amount of the notes and (ii) neither PPL nor any of its other subsidiaries will purchase the notes before the end of March 2037, except, subject to certain limitations, to the extent that the applicable redemption or repurchase price or principal amount defeased does not exceed a specified amount of proceeds from the sale of qualifying replacement capital securities during the 180-day period prior to the date of that redemption, repurchase or defeasance. The designated series of covered debt benefiting from the Replacement Capital Covenant at December 31, 2009 and 2008 was PPL Capital Funding's 6.85% Senior Notes due 2047.
- (e) Represents lease financing consolidated through a variable interest entity. See Note 3 for additional information.
- (f) The 1945 First Mortgage Bonds were issued under, and secured by, the lien of the 1945 First Mortgage Bond Indenture. In December 2008, PPL Electric completed an in-substance defeasance of the First Mortgage Bonds by depositing sufficient funds with the trustee solely to satisfy the principal and remaining interest obligations on the bonds when due. The amount of funds on deposit with the trustee was \$14 million at December 31, 2009 and \$15 million at December 31, 2008, and is recorded as restricted cash, primarily in other noncurrent assets on the Balance Sheets.

Also in December 2008, PPL Electric discharged the lien under the 1945 First Mortgage Bond Indenture, which covered substantially all electric distribution plant and certain transmission plant owned by PPL Electric.

- (g) The senior secured bonds are secured by the lien of the 2001 Senior Secured Bond Indenture, which covers substantially all electric distribution plant and certain transmission plant owned by PPL Electric.

In May 2009, PPL Electric issued \$300 million of 6.25% First Mortgage Bonds due 2039 (6.25% Bonds). The 6.25% Bonds may be redeemed any time prior to maturity at PPL Electric's option at make-whole redemption prices. PPL Electric received proceeds of \$296 million, net of a discount and underwriting fees, from the issuance of the 6.25% Bonds. Approximately \$86 million of the proceeds were used in August 2009 to partially fund the repayment at maturity of \$486 million aggregate principal amount of PPL Electric's Senior Secured Bonds, 6-1/4% Series. The balance of such repayment was funded from the issuance in October 2008 of \$400 million of 7.125% Senior Secured Bonds due 2013. The balance of the proceeds from the issuance of the 6.25% Bonds was used for general corporate purposes, including capital expenditures.

In December 2009, PPL Electric Utilities redeemed the entire \$100 million aggregate principal amount of its 4.30% Senior Secured Bonds due 2013. PPL Electric paid a premium of \$9 million in connection with the redemption. The total loss on the redemption of approximately \$10 million pre-tax, which includes unamortized fees and discounts, is reflected in "Regulatory assets" and "Other regulatory and noncurrent assets" on the Balance Sheets of PPL and PPL Electric at December 31, 2009 as an unamortized loss on reacquired debt and will be amortized through the original maturity of the debt. Additionally, PPL recorded a net gain of approximately \$4 million pre-tax in "Other Income - net" on the Statement of Income as a result of reclassifying gains and losses on related cash flow and fair value hedges from AOCI and Long-term Debt into earnings.

- (h) PPL Electric issued a series of its senior secured bonds to secure its obligations to make payments with respect to each series of Pollution Control Bonds that were issued by the LCIDA and the PEDFA on behalf of PPL Electric. These senior secured bonds were issued in the same principal amount, contain payment and redemption provisions that correspond to and bear the same interest rate as such Pollution Control Bonds. These senior secured bonds were issued under the 2001 Senior Secured Bond Indenture and are secured as noted in (g) above.
- (i) The senior secured bonds may be redeemed at par beginning in 2015.
- (j) The related Pollution Control Bonds are structured as variable-rate remarketable bonds. PPL Electric may convert the interest rate on the bonds from time to time to a commercial paper rate, daily rate, weekly rate or a term rate of at least one year. The bonds are subject to mandatory purchase under certain circumstances, including upon conversion to a different interest rate mode. To the extent that a purchase is required prior to the maturity date, PPL Electric has the ability and intent to refinance the bonds on a long-term basis. At December 31, 2009 and 2008, the bonds were in a term rate mode and bear interest at 4.85% until October 2010, at which time the bonds will be remarketed based upon the interest rate mode elected by PPL Electric.
- .) The PEDFA issued Exempt Facilities Revenue Bonds on behalf of PPL Energy Supply in December 2007 (Series 2007 Bonds) and December 2008 (Series 2008 Bonds). In connection with the issuances of such bonds, PPL Energy Supply entered into loan agreements with the PEDFA pursuant to which the PEDFA loaned to PPL Energy Supply the proceeds of the bonds on payment terms that correspond to those of the bonds. PPL Investment Corp. acted as initial purchaser of the Series 2008 Bonds upon issuance. At December 31, 2008,

the Series 2007 Bonds and the Series 2008 Bonds bore interest at 3.20% and 5.50%.

In April 2009, the PEDFA issued \$231 million aggregate principal amount of Exempt Facilities Revenue Refunding Bonds, Series 2009A and 2009B due 2038 and Series 2009C due 2037 (PPL Energy Supply, LLC Project), on behalf of PPL Energy Supply. The Series 2009A bonds, in an aggregate principal amount of \$100 million, and the Series 2009B bonds, in an aggregate principal amount of \$50 million, were issued by the PEDFA in order to refund \$150 million aggregate principal amount of Exempt Facilities Revenue Bonds, Series 2008A and 2008B (PPL Energy Supply, LLC Project) due 2038 that were issued by the PEDFA in December 2008 on behalf of PPL Energy Supply, and for which PPL Investment Corp. acted as initial purchaser. The Series 2009C bonds, in an aggregate principal amount of \$81 million, were issued in order to refund \$81 million aggregate principal amount of Exempt Facilities Revenue Bonds, Series 2007 (PPL Energy Supply, LLC Project) due 2037 that were issued by the PEDFA in December 2007 on behalf of PPL Energy Supply. Among other things, the completed refundings were able to take advantage of provisions in the Economic Stimulus Package that eliminated the application of the AMT to interest payable on the refinanced indebtedness. The refundings of the bonds were effected by the ultimate distribution of \$231 million by the PEDFA to the bond holders, including PPL Investment Corp. As a result of the refundings of the bonds, PPL Investment Corp. received proceeds of \$150 million, which is reflected as a cash flow from investing activities on the Statement of Cash Flows for PPL and PPL Energy Supply in 2009.

Similar to the Series 2007 Bonds and the Series 2008 Bonds, the Series 2009A, 2009B and 2009C bonds are structured as variable-rate remarketable bonds. PPL Energy Supply may convert the interest rate mode on the bonds from time to time to a commercial paper rate, daily rate, weekly rate or a term rate of at least one year. The bonds are subject to mandatory purchase under certain circumstances, including upon conversion to a different interest rate mode, and are subject to mandatory redemption upon a determination that the interest on the bonds would be included in the holders' gross income for federal tax purposes. To the extent that a purchase is required prior to the maturity date, PPL Energy Supply has the ability and intent to refinance the bonds on a long-term basis. The Series 2009A bonds bore interest at an initial rate of 0.90% through June 30, 2009. The Series 2009B bonds bore interest at an initial rate of 1.25% through September 30, 2009. The Series 2009C bonds were in a weekly interest rate mode through December 9, 2009.

PPL Energy Supply elected to change the interest rate mode on the Series 2009A and Series 2009B bonds to a commercial paper rate mode upon expiration of the initial rate period for each series. The Series 2009A bonds were converted to a commercial paper rate mode in July 2009 and currently bear interest at 0.62% through August 31, 2010. The Series 2009B bonds were converted to a commercial paper rate mode in October 2009 and currently bear interest at 0.50% through March 31, 2010. At the end of each commercial paper rate period, the bonds will be remarketed based upon an interest rate mode elected by PPL Energy Supply.

PPL Energy Supply converted the interest rate mode on the Series 2009C bonds from a weekly interest rate mode to a commercial paper rate mode in December 2009. The bonds currently bear interest at 0.62% through August 31, 2010, at which time the bonds will be remarketed based upon an interest rate mode elected by PPL Energy Supply.

In connection with the issuance of each series of bonds by the PEDFA, PPL Energy Supply entered into separate loan agreements with the PEDFA pursuant to which the PEDFA loaned to PPL Energy Supply the proceeds of the Series 2009A, Series 2009B and Series 2009C bonds on payment terms that correspond to those of the bonds. PPL Energy Supply issued separate promissory notes to the PEDFA to evidence its obligations under each of the loan agreements. These loan agreements and promissory notes replaced those associated with the refunded 2007 and 2008 PEDFA bonds in a non-cash transaction that is excluded from the Statement of Cash Flows in 2009.

Separate letters of credit were issued under PPL Energy Supply's \$3.2 billion five-year syndicated credit facility to the trustee in support of each series of bonds. The letters of credit permit the trustee to draw amounts to pay principal of and interest on, and the purchase price of, the Series 2009A, Series 2009B and Series 2009C bonds when due. PPL Energy Supply is required to reimburse any draws on the letters of credit within one business day of such draw.

- (l) In June 2009, PPL Electric repaid its \$9 million obligation under a Variable Rate Pollution Control Facilities Note in connection with the early redemption in full of the underlying pollution control revenue bonds that were issued by the Indiana County Industrial Development Authority and due in June 2027.
- (m) Although financial information of foreign subsidiaries is recorded on a one-month lag, WPD's December 2008 retirement of \$225 million of senior notes is reflected in the 2008 Financial Statements and its December 2007 retirement of \$175 million of senior notes is reflected in the 2007 Financial Statements due to the materiality of these retirements.

Includes £225 million (\$369 million at December 31, 2009 and \$345 million at December 31, 2008) of notes that may be redeemed, in total but not in part, on December 21, 2026, at the greater of the principal value or a value determined by reference to the gross redemption yield on a nominated U.K. Government bond. Additionally, the £225 million of such notes may be put by the holders back to the issuer for redemption if the long-term credit ratings assigned to the notes by Moody's, S&P or Fitch are withdrawn by any of the rating agencies or reduced to a non-investment grade rating of Ba1 or BB+ in connection with a restructuring event. A restructuring event includes the loss of, or a material adverse change to, the distribution license under which the issuer operates.

Change from 2008 to 2009 includes an increase of \$66 million resulting from movements in foreign currency exchange rates.

- ) The principal amount of these notes is adjusted on a semi-annual basis based on changes in a specified index, as detailed in the terms of the related indentures. The adjustment to the principal amount from 2008 to 2009 was a decrease of approximately £3 million (\$6 million) and is offset by a \$26 million increase resulting from movements in foreign currency exchange rates.

These notes may be redeemed, in total by series, on December 1, 2026, at the greater of the adjusted principal value and a make-whole

value determined by reference to the gross real yield on a nominated U.K. government bond. Additionally, these notes may be put by the holders back to the issuer for redemption if the long-term credit ratings assigned to the notes by Moody's, S&P or Fitch are withdrawn by any of the rating agencies or reduced to a non-investment grade rating of Ba1 or BB+ in connection with a restructuring event. A restructuring event includes the loss of, or a material adverse change to, the distribution license under which the issuer operates.

- j) Represents adjustments made to record WPD's long-term debt at fair value at the time of acquisition of the controlling interest in WPD in 2002.

#### **Legal Separateness (PPL, PPL Energy Supply and PPL Electric)**

In 2001, PPL Electric completed a strategic initiative to confirm its legal separation from PPL and PPL's other affiliated companies. This initiative was designed to enable PPL Electric to substantially reduce its exposure to volatility in energy prices and supply risks through 2009 and to reduce its business and financial risk profile by, among other things, limiting its business activities to the transmission and distribution of electricity and businesses related to or arising out of the electric transmission and distribution businesses. In connection with this initiative, PPL Electric:

- obtained long-term electric supply contracts to meet its PLR obligations (with its affiliate PPL EnergyPlus) through 2009, as further described in Note 15 under "PLR Contracts" (also see Note 14 under "Energy Purchase Commitments" for information on current PLR supply procurement procedures);
- agreed to limit its businesses to electric transmission and distribution and related activities;
- adopted amendments to its Articles of Incorporation and Bylaws containing corporate governance and operating provisions designed to clarify and reinforce its legal and corporate separateness from PPL and its other affiliated companies;
- appointed an independent director to its Board of Directors and required the unanimous approval of the Board of Directors, including the consent of the independent director, to amendments to these corporate governance and operating provisions or to the commencement of any insolvency proceedings, including any filing of a voluntary petition in bankruptcy or other similar actions.

In addition, in connection with the issuance of certain series of bonds, PPL Electric entered into a compliance administration agreement with an independent compliance administrator to review, on a semi-annual basis, its compliance with the corporate governance and operating requirements contained in its Articles of Incorporation and Bylaws. Such series of bonds are no longer outstanding and the compliance administration agreement has terminated, but PPL Electric continues to comply with the corporate separateness provisions in its Articles of Incorporation and Bylaws.

The enhancements to PPL Electric's legal separation from its affiliates are intended to minimize the risk that a court would order PPL Electric's assets and liabilities to be substantively consolidated with those of PPL or another affiliate of PPL in the event that PPL or another PPL affiliate were to become a debtor in a bankruptcy case. Based on these various measures, PPL Electric was able to issue and maintain a higher level of debt and use it to replace higher cost equity, thereby maintaining a lower total cost of capital. Nevertheless, if PPL or another PPL affiliate were to become a debtor in a bankruptcy case, there can be no assurance that a court would not order PPL Electric's assets and liabilities to be consolidated with those of PPL or such other PPL affiliate.

The subsidiaries of PPL are separate legal entities. PPL's subsidiaries are not liable for the debts of PPL. Accordingly, creditors of PPL may not satisfy their debts from the assets of the subsidiaries absent a specific contractual undertaking by a subsidiary to pay PPL's creditors or as required by applicable law or regulation. Similarly, absent a specific contractual undertaking or as required by applicable law or regulation, PPL is not liable for the debts of its subsidiaries. Accordingly, creditors of PPL's subsidiaries may not satisfy their debts from the assets of PPL absent a specific contractual undertaking by PPL to pay the creditors of its subsidiaries or as required by applicable law or regulation.

Similarly, the subsidiaries of PPL Energy Supply and PPL Electric are separate legal entities. These subsidiaries are not liable for the debts of PPL Energy Supply and PPL Electric. Accordingly, creditors of PPL Energy Supply and PPL Electric may not satisfy their debts from the assets of their subsidiaries absent a specific contractual undertaking by a subsidiary to pay the creditors or as required by applicable law or regulation. In addition, absent a specific contractual undertaking or as required by applicable law or regulation, PPL Energy Supply and PPL Electric are not liable for the debts of their subsidiaries. Accordingly, creditors of these subsidiaries may not satisfy their debts from the assets of PPL Energy Supply or PPL Electric absent a specific contractual undertaking by that parent to pay the creditors of its subsidiaries or as required by applicable law or regulation.

#### **Common Stock Repurchase Program (PPL)**

In June 2007, PPL's Board of Directors authorized the repurchase by PPL of up to \$750 million of its common stock. A total of 15,732,708 shares were repurchased for \$750 million, excluding related fees, under the plan during 2008 and 2007. These purchases were primarily recorded as a reduction to "Capital in excess of par value" on the Balance Sheet.

#### **Distributions, Capital Contributions and Related Restrictions**

*(PPL)*

February 2009, PPL announced an increase to its quarterly common stock dividend, effective April 1, 2009, to 34.5 cents per share (equivalent to \$1.38 per annum). Future dividends, declared at the discretion of the Board of Directors, will be dependent upon future earnings, cash flows, financial requirements and other factors.

Neither PPL Capital Funding nor PPL may declare or pay any cash dividend or distribution on its capital stock during any period in which PPL

Capital Funding defers interest payments on its 2007 Series A Junior Subordinated Notes due 2067. At December 31, 2009, no interest payments were deferred.

*(PPL and PPL Energy Supply)*

The PPL Montana Colstrip lease places certain restrictions on PPL Montana's ability to declare dividends. At this time, PPL believes that these covenants will not limit PPL's or PPL Energy Supply's ability to operate as desired and will not affect their ability to meet any of their cash obligations. WPD subsidiaries also have financing arrangements that limit their ability to pay dividends. However, PPL does not, at this time, expect that any of such limitations would significantly impact PPL's or PPL Energy Supply's ability to meet their cash obligations.

*(PPL Energy Supply)*

During 2009, PPL Energy Supply distributed \$943 million to its parent company, PPL Energy Funding, and received cash capital contributions of \$50 million.

*(PPL and PPL Electric)*

As discussed in Note 6, PPL Electric may not pay dividends on its common stock, except in certain circumstances, unless full dividends have been paid on the Preference Shares for the then-current dividend period. The quarterly dividend rate for PPL Electric's Preference Shares is \$1.5625 per share. PPL Electric has declared and paid dividends on its outstanding Preference Shares since issuance. Dividends on the Preference Shares are not cumulative and future dividends, declared at the discretion of PPL Electric's Board of Directors, will be dependent upon future earnings, cash flows, financial requirements and other factors.

PPL Electric is subject to Section 305(a) of the Federal Power Act, which makes it unlawful for a public utility to make or pay a dividend from any funds "properly included in capital account." The meaning of this limitation has never been clarified under the Federal Power Act. PPL Electric believes, however, that this statutory restriction, as applied to its circumstances, would not be construed or applied by the FERC to prohibit the payment from retained earnings of dividends that are not excessive and are for lawful and legitimate business purposes.

*(PPL Electric)*

During 2009, PPL Electric paid common stock dividends of \$274 million to PPL, and received cash capital contributions of \$400 million.

## **8. Acquisitions, Development and Divestitures**

*PPL, PPL Energy Supply and PPL Electric)*

PPL and its subsidiaries continuously evaluate strategic options and, from time to time, PPL and its subsidiaries negotiate with third parties regarding acquisitions and dispositions of businesses and assets, joint ventures and development projects, which may or may not result in consummated transactions. Any such transactions may impact future financial results. See Note 9 for information on anticipated and completed sales of businesses that were presented as discontinued operations by PPL and PPL Energy Supply.

### **Domestic**

License Renewals *(PPL and PPL Energy Supply)*

PPL Susquehanna operates Units 1 and 2 pursuant to NRC operating licenses. In November 2009, the NRC approved PPL Susquehanna's application for 20-year license renewals for each of the Susquehanna units, extending the expiration date to 2042 for Unit 1 and to 2044 for Unit 2. At December 31, 2009 and 2008, \$17 million and \$15 million of license renewal costs were capitalized and are included in noncurrent "Other intangibles" on the Balance Sheets.

Development

*(PPL and PPL Energy Supply)*

In 2007, PPL requested FERC approval to expand the capacity of its Holtwood hydroelectric plant by 125 MW. In 2008, PPL withdrew the application due to then-prevailing economic conditions, including the high cost of capital and projected future energy prices. As a result, the Supply segment recorded an impairment of \$22 million (\$13 million after tax), which is included in "Other operation and maintenance" on the Statements of Income.

In April 2009, PPL filed a new application with the FERC to expand capacity at its Holtwood hydroelectric plant by 125 MW, and in October 2009 the FERC granted the approval. PPL reconsidered this project in light of the availability of tax incentives and potential federal loan guarantees for renewable projects contained in the Economic Stimulus Package. In approving this application, the FERC extended the operating license for the Holtwood plant to August 2030. The expansion project has an expected capital cost of approximately \$434 million. The preparation began in the fourth quarter of 2009 and construction began in the first quarter of 2010, with commercial operations scheduled to begin in 2013. A PPL subsidiary has applied to the DOE for a federal loan guarantee for the project.

In March 2009, PPL Montana received FERC approval for its request to redevelop the Rainbow hydroelectric facility, near Great Falls, Montana, for total plant capacity of approximately 60 MW (an increase of 28 MW). The expected redevelopment project cost is \$230

million. Construction began in October 2009, with commercial operations scheduled to begin in 2012. A PPL subsidiary has applied to the DOE for a federal loan guarantee for the project.

In 2008, PPL Susquehanna received NRC approval for its request to increase the generation capacity of the Susquehanna nuclear plant. The total expected capacity increase is 159 MW, of which PPL Susquehanna's 90% ownership share is 143 MW. The first uprate for Unit 1 was 10 MW and was completed in 2008. The second uprate for Unit 1 is scheduled to be completed in 2010. The first uprate for Unit 2 was 50 MW and was completed in 2009, and the second uprate is scheduled to be completed in 2011. The remaining increase is 59 MW, of which PPL Susquehanna's share is 53 MW. PPL Susquehanna's share of the expected capital cost for the total uprate of 143 MW is \$345 million.

In October 2008, a PPL subsidiary submitted a COLA to the NRC for the proposed Bell Bend nuclear generating unit (Bell Bend) to be built adjacent to PPL's Susquehanna plant. The COLA was formally docketed and accepted for review by the NRC in December 2008. The NRC is now reviewing the COLA. In May 2009, the NRC published its official review schedule that culminates with issuance of Bell Bend's final safety evaluation report in 2012, after which public hearings will be held before Bell Bend's license can be issued.

In 2008, a PPL subsidiary submitted Parts I and II of an application for a federal loan guarantee for Bell Bend to the DOE. In June 2009, the DOE announced that it was working to finalize loan guarantees related to four projects, none of which was Bell Bend. None of the ten applicants who submitted Part II applications has been formally eliminated by the DOE; however, the DOE has stated that the \$18.5 billion currently appropriated to support new nuclear projects would not likely be enough for more than four projects. A PPL subsidiary submits quarterly application updates for Bell Bend to the DOE to remain active in the loan application process and plans to continue to do so in 2010.

The President's proposed budget for fiscal year 2011 includes an additional \$36 billion of loan guarantees for nuclear projects. If this increased loan guarantee authorization is approved, PPL believes that Bell Bend could be a candidate for a share of such additional guarantees. However, PPL has made no decision to proceed with construction of Bell Bend and expects that such decision will not be made for several years given the anticipated lengthy NRC license approval process. Additionally, PPL has announced that it does not expect to proceed with construction absent a joint arrangement with other interested parties and a federal loan guarantee or other acceptable financing. PPL and its subsidiaries are authorized by PPL's Board of Directors to spend up to \$111 million on the COLA and other permits necessary for construction. At December 31, 2009 and 2008, \$77 million and \$58 million of costs associated with the licensing application were capitalized and are included in noncurrent "Other intangibles" on the Balance Sheets, as PPL believes it is probable that these costs are ultimately recoverable following approval by the NRC either through construction of the new nuclear unit, transfer of the COLA rights to a joint venture, or sale of the COLA rights to another party.

*(PPL and PPL Electric)*

In June 2007, the PJM directed the construction of a new 150-mile, 500-kilovolt transmission line between the Susquehanna substation in Pennsylvania and the Roseland substation in New Jersey that it identified as essential to long-term reliability of the mid-Atlantic electricity grid. The PJM determined that the line is needed to prevent potential overloads that could occur in the next decade on several existing transmission lines in the interconnected PJM system. The PJM has directed PPL Electric to construct the portion of the Susquehanna-Roseland line in Pennsylvania and has directed Public Service Electric & Gas Company to construct the portion of the line in New Jersey, in each case by June 1, 2012. PPL Electric's estimated share of the project costs at December 31, 2009 was \$510 million.

This project is pending certain regulatory approvals. PPL Electric has identified the approximately 100-mile route for the Pennsylvania portion of the line. In February 2010, the PUC and the New Jersey Board of Public Utilities approved the project. In addition, both companies are working with the National Park Service to obtain any approvals that may be required to route the line through the Delaware Water Gap National Recreation Area. PPL Electric cannot predict the ultimate outcome or timing of the National Park Service approval. However, PPL Electric currently anticipates delays in the approval process which will affect the PJM-directed in-service date and projected costs of the line. PPL Electric also cannot predict what action, if any, the PJM might take in the event of a delay to its scheduled in-service date for the new line.

*(PPL and PPL Energy Supply)*

#### Sale of Telecommunication Operations

In the first quarter of 2007, PPL completed a review of strategic options for the transport operations of its domestic telecommunications subsidiary, which offered fiber optic capacity to other telecommunications companies and enterprise customers. The operating results of this subsidiary were included in the Supply segment. Due to significant capital requirements for the telecommunication operations and competing capital needs in PPL's core electricity supply and delivery businesses, PPL decided to market these operations. The transport operations did not meet the criteria for discontinued operations on the Statement of Income because there were not separate and distinguishable cash flows, among other factors. In August 2007, PPL sold its telecommunication operations.

In connection with the sale, in 2007 PPL and PPL Energy Supply recorded impairments of \$39 million (\$23 million after tax) of the telecommunication assets based on their estimated fair value. The impairments are included in "Energy-related businesses" expenses on the Statement of Income. PPL realized net proceeds of \$47 million from the sale.

#### Acquisition of a Long-term Tolling Agreement

In 2008, PPL EnergyPlus acquired the rights to an existing long-term tolling agreement associated with the capacity and energy of Ironwood. The tolling agreement extends through 2021 and is considered to contain an operating lease for accounting purposes. As a result of this agreement, PPL EnergyPlus recognized an intangible asset. See Note 10 for additional information on the lease.

## 9. Discontinued Operations

(PPL and PPL Energy Supply)

### Anticipated Sale of Long Island Generation Business

As a result of management's ongoing strategic review of PPL's non-core asset portfolio, in May 2009, PPL Generation signed a definitive agreement to sell its Long Island generation business, which is included in the Supply segment, for approximately \$135 million in cash, adjusted for working capital at the sale date and subject to reduction monthly, effective September 1, 2009. The Long Island Power Authority has contracted with PPL Energy Supply subsidiaries to purchase all of this business' capacity and ancillary services as part of tolling agreements that expire in 2017 and 2018. Each agreement is considered to contain a lease for accounting purposes. These tolling agreements will be transferred to the purchaser upon completion of the sale.

The Long Island generation business met the held for sale criteria in the second quarter of 2009. As a result, net assets held for sale with a carrying amount of \$189 million were written down to their estimated fair value (less cost to sell) of \$137 million at June 30, 2009, resulting in a pre-tax impairment charge of \$52 million (\$34 million after tax). At both September 30 and December 31, 2009, the estimated fair value (less cost to sell) was remeasured and additional impairments totaling \$10 million (\$3 million after tax) were recorded. In addition, \$2 million (\$1 million after tax) of goodwill allocated to this business was written off in 2009. The impairment charges recognized in the third and fourth quarters of 2009 had no significant impact on earnings, as such amounts were substantially offset by tolling revenues from the Long Island generation assets. These charges are included in "Income (Loss) from Discontinued Operations (net of income taxes)" on the 2009 Statement of Income. Closing of the sale is expected to occur on or about February 26, 2010. After adjusting for the delayed closing provisions, proceeds will approximate \$125 million, excluding working capital.

Following are the components of Discontinued Operations in the Statements of Income.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Operating revenues	\$ 24	\$ 26	\$ 28
Operating expenses (a)	73	8	8
Operating income (loss)	(49)	18	20
Interest expense (b)	4	3	2
Income (loss) before income taxes	(53)	15	18
Income taxes	(20)	5	8
Income (Loss) from Discontinued Operations	<u>\$ (33)</u>	<u>\$ 10</u>	<u>\$ 10</u>

(a) 2009 includes impairments to the carrying value of the business.

(b) Represents allocated interest expense based upon debt attributable to PPL's Long Island generation business.

The major classes of assets reported as held for sale on the Balance Sheet at December 31, 2009 were \$41 million of PP&E and an \$86 million net investment in a direct-financing lease (corresponding amounts at December 31, 2008, were \$88 million of PP&E and a \$104 million net investment in a direct-financing lease, which have not been reclassified on the Balance Sheet as of that date).

### Sale of Maine Hydroelectric Generation Business

In 2004, PPL Maine entered into an agreement with a coalition of government agencies and private groups to sell three of its hydroelectric facilities in Maine. Under the agreement, a non-profit organization designated by the coalition received a five-year option to purchase the hydroelectric facilities for \$25 million and, if the option was exercised, PPL Maine would receive rights to increase energy output at its other Maine hydroelectric facilities. The coalition announced plans to remove or bypass the subject facilities to restore runs of Atlantic salmon and other migratory fish to the Penobscot River. In June 2008, the coalition notified PPL Maine of its intent to exercise the purchase option. The agreement requires updates to its representations and warranties, and is subject to approvals by the FERC and other regulatory agencies. In November 2008, PPL Maine and the coalition requested the FERC, the U.S. Army Corps of Engineers and the Maine DEP to approve the transfer of ownership of the three facilities. Certain of these required approvals have been obtained, but PPL cannot predict whether or when all of them will be obtained. As a result, these three Maine hydroelectric facilities did not meet the held for sale criteria at December 31, 2009.

In July 2009, indirectly related to the above potential sale and as a result of management's ongoing strategic review of PPL's non-core asset portfolio, PPL Maine signed a definitive agreement to sell the majority of its hydroelectric generation business, which was included in the Supply segment. PPL completed this sale in November 2009 for \$81 million in cash, adjusted for working capital. The assets sold in this transaction included five hydroelectric facilities and PPL's 50% equity interest in a sixth hydroelectric facility, which had been accounted for as an equity investment, as well as the rights to increase energy output at these facilities if the potential sale of the three other hydroelectric facilities (discussed above) is completed. PPL's interest in these six facilities represented a total of 30 MW of electric generating capacity. As a result of this sale, PPL recorded a gain of \$38 million (\$22 million after tax), reflected in "Income (Loss) from Discontinued Operations (net of income taxes)" on the 2009 Statement of Income. In addition, upon completion of the sale of the three other hydroelectric facilities noted above, PPL will receive \$14 million in contingent consideration and record an associated additional after-tax gain of between \$7 and \$9 million.

Following are the components of Discontinued Operations in the Statements of Income.



	<u>2009</u>	<u>2008</u>	<u>2007</u>
Operating revenues	\$ 5	\$ 11	\$ 8
Operating expenses (a)	(34)	3	4
Operating income	39	8	4
Other income-net	3	2	2
Interest expense (b)	1	1	
Income before income taxes	41	9	6
Income taxes	17	4	4
Income from Discontinued Operations	<u>\$ 24</u>	<u>\$ 5</u>	<u>\$ 2</u>

(a) 2009 includes the gain recorded on the sale.

(b) Represents allocated interest expense based upon debt attributable to the Maine hydroelectric generation business.

Upon completion of the sale, \$23 million of PP&E, an \$18 million equity method investment and \$1 million of allocated goodwill were removed from the Balance Sheet.

#### Sale of Interest in Wyman Unit 4

As a result of management's ongoing strategic review of PPL's non-core asset portfolio, in December 2009, PPL Maine sold its 8.33% ownership interest in the 610 MW Wyman Unit 4 generating station, an oil-fired plant located in Yarmouth, Maine. PPL's interest in the plant was included in the Supply segment. In connection with the sale, PPL recorded a loss of \$6 million (\$4 million after tax). This charge is included in "Income (Loss) from Discontinued Operations (net of income taxes)" on the 2009 Statement of Income. PPL's share of the results of operations for the years 2007 - 2009 was insignificant.

#### Sale of Latin American Businesses

In March 2007, PPL completed a review of strategic options for its Latin American businesses and announced its intention to sell its regulated electricity delivery businesses in Chile, El Salvador and Bolivia, which were included in the International Delivery segment.

In April 2007, PPL agreed to sell its Bolivian businesses. As a result, in 2007, PPL recorded impairments totaling \$37 million (\$20 million after tax) to reflect the estimated fair value of the businesses at the date of the agreement. This sale was completed in July 2007. In May 2007, PPL completed the sale of its El Salvadoran business for \$180 million in cash. PPL recorded a gain of \$94 million (\$89 million after tax) as a result of the sale. In November 2007, PPL completed the sale of its Chilean business for \$660 million in cash and recorded a related gain of \$306 million (\$197 million after tax).

In 2008, PPL Global recognized income tax benefits and miscellaneous expenses in Discontinued Operations in connection with the dissolution of certain Latin American holding companies. This process was substantially completed in 2008.

In 2009, PPL identified a correction to the previously computed tax bases of the Latin American businesses. The most significant adjustment related to the sale of the El Salvadoran business and was largely due to returns of capital in certain prior years that had not been reflected in the calculated tax basis. As a result, PPL and PPL Energy Supply recorded \$24 million of additional income tax expense in 2009, which is reflected on the Statement of Income in "Income (Loss) from Discontinued Operations (net of income taxes)." The additional expense is not considered by management to be material to the financial statements of PPL and PPL Energy Supply for the years ended 2007 and 2009.

Following are the components of Discontinued Operations in the Statements of Income.

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Operating revenues			\$ 529
Operating expenses (a)		\$ 2	497
Operating income (loss)		(2)	32
Other income - net		(1)	15
Interest expense (b)			25
Income (Loss) before income taxes		(3)	22
Income taxes (c)	\$ 27	(8)	(5)
Gain on sale of businesses (net of tax expense of \$114 million)			286
Income (Loss) from Discontinued Operations	(27)	5	313
Income from Discontinued Operations Attributable to Noncontrolling Interests			6
Income (Loss) from Discontinued Operations Attributable to PPL/PPL Energy Supply	<u>\$ (27)</u>	<u>\$ 5</u>	<u>\$ 307</u>

(a) 2007 includes the impairments to the carrying value of the Bolivian businesses. Also included are fees associated with the divestiture of the Latin American businesses of \$12 million (\$7 million after tax).

- (b) 2007 includes \$5 million of allocated interest expense based on the discontinued operation's share of the net assets of PPL Energy Supply.
- (c) 2009 includes the \$24 million income tax adjustment referred to above. 2008 includes \$6 million from the recognition of a previously unrecognized tax benefit associated with a prior year tax position. 2007 includes U.S. deferred tax charges of \$7 million. As a result of PPL's decision to sell its Latin American businesses, it no longer qualified for the permanently reinvested exception to recording deferred taxes.

(PPL)

#### Sale of Gas and Propane Businesses

In July 2007, PPL completed a review of strategic options for its natural gas distribution and propane businesses and announced its intention to sell these businesses, which were included in the Pennsylvania Delivery segment. Based on the expectation that the natural gas distribution and propane assets would be sold and an assessment of prevailing market conditions, an impairment charge of \$22 million and an associated income tax benefit of \$1 million were recorded in 2007.

In March 2008, PPL signed a definitive agreement to sell these businesses for \$268 million in cash, adjusted for working capital at the sale date, pursuant to a stock purchase agreement. PPL completed the sale in October 2008. Sale proceeds of \$303 million, including estimated working capital, were contributed to PPL Energy Supply through its parent, PPL Energy Funding. In 2008, PPL recorded impairment and other charges related to the sale totaling \$10 million (\$6 million after tax). Also in 2008, PPL Gas Utilities paid a \$3 million (\$2 million after tax) premium to prepay the entire \$10 million aggregate principal of its 8.70% Senior Notes due December 2022. In the first quarter of 2009, PPL recognized an insignificant charge in Discontinued Operations in connection with the settlement of the working capital adjustment.

Following are the components in Discontinued Operations in the Statements of Income.

	<u>2008</u>	<u>2007</u>
Operating revenues	\$ 162	\$ 218
Operating expenses (a)	<u>154</u>	<u>211</u>
Operating income	8	7
Other income - net	(3)	
Interest expense (b)	<u>4</u>	<u>6</u>
Income before income taxes	1	1
Income taxes (c)	<u>(2)</u>	<u>33</u>
Income (Loss) from Discontinued Operations	<u>\$ 3</u>	<u>\$ (32)</u>

(a) 2008 and 2007 include impairment and other charges related to the sale of \$10 million and \$22 million.

(b) 2008 and 2007 include \$3 million and \$5 million of allocated interest expense based upon debt attributable to PPL's natural gas distribution and propane businesses.

(c) As a result of classifying the natural gas distribution and propane businesses as Discontinued Operations in 2007, PPL recorded a deferred income tax charge of \$23 million related to its book/tax basis difference in the investment in these assets.

#### **10. Leases**

(PPL and PPL Energy Supply)

##### **Lessee Transactions**

###### Tolling Agreement

In 2008, PPL EnergyPlus acquired the rights to an existing long-term tolling agreement for the capacity and energy of Ironwood. Under the agreement, PPL EnergyPlus has control over the plant's dispatch into the electricity grid and will supply the natural gas necessary to operate the plant. The tolling agreement extends through 2021 and is considered to contain an operating lease for accounting purposes. The fixed payments under the tolling agreement are subject to adjustment based upon changes to the facility capacity rating, which may occur up to twice per year. Certain costs within the tolling agreement, primarily non-lease costs, are subject to escalation.

###### Colstrip Generating Plant

In July 2000, PPL Montana sold its interest in the Colstrip generating plants to owner lessors who are leasing a 50% interest in Colstrip Units 1 and 2 and a 30% interest in Unit 3 back to PPL Montana under four 36-year non-cancelable leases. This transaction is accounted for as a sale-leaseback and classified as an operating lease. These leases provide two renewal options based on the economic useful life of the generation assets. PPL Montana currently amortizes material leasehold improvements over no more than the remaining life of the original leases. PPL Montana is required to pay all expenses associated with the operations of the generation units. The leases place certain restrictions on PPL Montana's ability to incur additional debt, sell assets and declare dividends and require PPL Montana to maintain certain financial ratios related to cash flow and net worth. There are no residual value guarantees in these leases. However, upon an event of default or an event of loss, PPL Montana could be required to pay a termination value of amounts sufficient to allow the lessor to repay amounts owing on the lessor notes and make the lessor whole for its equity investment and anticipated return on investment. The events of default include payment defaults, breaches of representations or covenants, acceleration of other indebtedness of PPL Montana, change in control of PPL Montana and certain bankruptcy

events. The termination value was estimated to be \$734 million at December 31, 2009.

#### Kerr Dam

At December 31, 2009, PPL Montana continued to participate in a lease arrangement with the Confederated Salish and Kootenai Tribes of the Flathead Reservation. Under a joint operating license, issued by the FERC to Montana Power in 1985, and subsequently to PPL Montana as a result of the purchase of Kerr Dam from Montana Power, PPL Montana is responsible to make payments to the tribes, for the use of their property. This agreement, subject to escalation based upon inflation, extends until the end of the license term in 2035. Between 2015 and 2025, the tribes have the option to purchase, hold and operate the project, which would result in the termination of this leasing arrangement.

#### Other Leases

PPL and its subsidiaries have entered into various agreements for the lease of office space, land and other equipment.

#### Rent - Operating Leases

Rent expense for PPL's and PPL Energy Supply's operating leases was \$86 million, \$73 million and \$54 million in 2009, 2008 and 2007.

Total future minimum rental payments for all operating leases are estimated to be:

2010	\$	108
2011		109
2012		107
2013		112
2014		111
Thereafter		421
	\$	<u>968</u> (a)

(a) Includes \$9 million in aggregate of future minimum lease payments related to the Long Island generation business. See Note 9 for additional information on the anticipated sale of this business.

#### **Lessor Transactions**

PPL Energy Supply subsidiary is the lessor, for accounting purposes, of each of the Shoreham and Edgewood plants (collectively with related tolling agreements, the Long Island generation business). In May 2009, PPL Generation signed a definitive agreement to sell the Long Island generation business. The tolling agreements related to these plants, accounted for as containing leases, will be transferred to the purchaser upon completion of the sale. See Note 9 for additional information.

#### Direct Financing Lease

The lease related to the Shoreham plant is classified as a direct-financing lease. Rental income received during 2009 and 2007 was \$14 million and \$13 million in 2008. Total future minimum lease payments are estimated at \$16 million for each of the years from 2010 through 2014. Substantially all of these lease payments are no longer expected to be received subsequent to the anticipated sale of the Long Island generation business.

#### Operating Lease

The lease related to the Edgewood plant is classified as an operating lease. At December 31, 2009, total minimum future rentals under this lease were estimated to be \$25 million, including \$3 million per year for 2010 through 2014. These minimum future rentals are no longer expected to be received subsequent to the anticipated sale of the Long Island generation business.

### **11. Stock-Based Compensation**

*(PPL, PPL Energy Supply and PPL Electric)*

Under the PPL Incentive Compensation Plan (ICP) and the Incentive Compensation Plan for Key Employees (ICPKE) (together, the Plans), restricted shares of PPL common stock, restricted stock units, performance units and stock options may be granted to officers and other key employees of PPL, PPL Energy Supply, PPL Electric and other affiliated companies. Awards under the Plans are made by the Compensation Governance and Nominating Committee (CGNC) of the PPL Board of Directors, in the case of the ICP, and by the PPL Corporate Leadership Council (CLC), in the case of the ICPKE.

The ICP limits the total number of awards that may be granted under it after April 23, 1999 to 15,769,430 awards, or 5% of the total shares of PPL common stock that were outstanding at April 23, 1999. The ICPKE limits the total number of awards that may be granted under it after April 25, 2003 to 16,573,608 awards, or 5% of the total shares of PPL common stock that were outstanding at January 1, 2003, reduced by outstanding awards of 2,373,812, for which PPL common stock was not yet issued as of April 25, 2003, resulting in a limit of 14,199,796. In addition, each Plan limits the number of shares available for awards in any calendar year to 2% of the outstanding common stock of PPL on the

first day of such calendar year. The maximum number of options that can be awarded under each Plan to any single eligible employee in any calendar year is three million shares. Any portion of these options that has not been granted may be carried over and used in any subsequent year. If any award lapses, is forfeited or the rights of the participant terminate, the shares of PPL common stock underlying such an award are again available for grant. Shares delivered under the Plans may be in the form of authorized and unissued PPL common stock, common stock held in treasury by PPL or PPL common stock purchased on the open market (including private purchases) in accordance with applicable securities laws.

### Restricted Stock and Restricted Stock Units

Restricted shares of PPL common stock are outstanding shares with full voting and dividend rights. Restricted stock awards are granted as a retention award for select key executives and vest when the recipient reaches a certain age or meets service or other criteria set forth in the executive's restricted stock award agreement. The shares are subject to forfeiture or accelerated payout under Plan provisions for termination, retirement, disability and death of employees. Restricted shares vest fully if control of PPL changes, as defined by the plans.

The Plans allow for the grant of restricted stock units. Restricted stock units are awards based on the fair market value of PPL common stock. Actual PPL common shares will be issued upon completion of a vesting period, generally three years. Recipients of restricted stock units may also be granted the right to receive dividend equivalents through the end of the restriction period or until the award is forfeited. Restricted stock units are subject to forfeiture or accelerated payout under the Plan provisions for termination, retirement, disability and death of employees. Restricted stock units vest fully if control of PPL changes, as defined by the Plans.

Restricted stock and restricted stock unit activity for 2009 was:

	<u>Restricted Shares/Units</u>		<u>Weighted-Average Grant Date Fair Value</u>
<b><u>PPL</u></b>			
Nonvested, beginning of period	1,656,830	\$	36.56
Granted	528,580		29.07
Vested	(743,968)		30.23
Forfeited	(33,400)		39.79
Nonvested, end of period	<u>1,408,042</u>		36.97
<b><u>PPL Energy Supply</u></b>			
Nonvested, beginning of period	788,010	\$	35.07
Granted	228,000		28.49
Vested	(416,548)		28.41
Forfeited	(22,050)		41.16
Nonvested, end of period	<u>577,412</u>		37.04
<b><u>PPL Electric</u></b>			
Nonvested, beginning of period	123,390	\$	39.28
Granted	81,230		29.49
Vested	(49,660)		33.44
Forfeited	(740)		42.94
Nonvested, end of period	<u>154,220</u>		36.05

Substantially all restricted stock and restricted stock unit awards are expected to vest.

The weighted-average grant date fair value of restricted stock and restricted stock units granted during 2008 was \$46.22 for PPL, \$46.03 for PPL Energy Supply and \$45.92 for PPL Electric.

The weighted-average grant date fair value of restricted stock and restricted stock units granted during 2007 was \$37.10 for PPL, \$37.88 for PPL Energy Supply and \$37.95 for PPL Electric.

At December 31, 2009, unrecognized compensation cost related to nonvested awards was:

	<u>Restricted Stock/Units Unrecognized Compensation Cost</u>	<u>Weighted-Average Period for Recognition</u>
PPL	\$ 11	2.8 years
PPL Energy Supply	5	1.7 years
PPL Electric	2	4.6 years

The total fair value of restricted shares/units vesting was:

<u>Year Ended December 31,</u>		
<u>2009</u>	<u>2008</u>	<u>2007</u>

PPL	\$	22	\$	25	\$	32
PPL Energy Supply		12		13		8
PPL Electric		2		2		4

### Performance Units

PPL began granting performance units in 2008. Performance units are intended to encourage and award future performance. Performance units represent a target number of shares (Target Award) of PPL's common stock that the officer would receive upon PPL's attainment of the applicable performance goal. Performance is determined based on total shareholder return during a three-year performance period. At the end of the period, payout is determined by comparing PPL's performance to the total shareholder return of the companies included in an Index Group, in this case the S&P Electric Utilities Index. Awards are payable on a graduated basis within the following ranges: if PPL's performance is at or above the 85th percentile of the Index Group, the award is paid at 200% of the Target Award; at the 50th percentile of the Index Group, the award is paid at 100% of the Target Award; at the 40th percentile of the Index Group, the award is paid at 50% of the Target Award; and below the 40th percentile, no award is payable. Dividends payable during the performance cycle accumulate and will be converted into additional performance units and are payable in shares of PPL common stock upon completion of the performance period based on the determination of the CGNC of whether the performance goals have been achieved. Under the Plan provisions, performance units are subject to forfeiture upon termination of employment except for retirement, disability or death of an employee, in which case the total performance units remain outstanding and eligible for vesting through the conclusion of the performance period. Performance units vest on a pro rata basis if control of PPL changes, as defined by the Plan.

Performance unit activity for 2009 was:

	<u>Performance Units</u>		<u>Weighted-Average Grant Date Fair Value</u>
<b>PPL</b>			
Nonvested, beginning of period	66,785	\$	48.94
Granted	106,587		39.76
Forfeited	(6,908)		45.06
Nonvested, end of period	<u>166,464</u>		43.23
<b>PPL Energy Supply</b>			
Nonvested, beginning of period	22,583	\$	48.58
Granted	27,451		38.18
Forfeited	(3,607)		49.04
Nonvested, end of period	<u>46,427</u>		42.39
<b>PPL Electric</b>			
Nonvested, beginning of period	3,732	\$	48.57
Granted	7,903		39.95
Nonvested, end of period	<u>11,635</u>		42.71

Substantially all performance unit awards are expected to vest.

The weighted-average grant date fair value of performance units granted during 2008 was \$48.97 for PPL, \$48.69 for PPL Energy Supply and \$48.57 for PPL Electric.

At December 31, 2009, unrecognized compensation cost related to nonvested awards was:

	<u>Performance Units Unrecognized Compensation Cost</u>	<u>Weighted-Average Period for Recognition</u>
PPL	\$ 4	1.8 years
PPL Energy Supply	1	1.8 years

At December 31, 2009, PPL Electric's unrecognized compensation cost was insignificant and the weighted-average period for recognition was 1.9 years.

The estimated fair value of each performance unit granted was calculated using a Monte Carlo pricing model that considers historical volatility over three years using daily stock price observations for PPL and all companies in the Index Group. Volatility over the expected term of the performance units is evaluated with consideration given to prior periods that may need to be excluded based on events not likely to recur that had impacted PPL and companies in the Index Group.

The weighted-average assumptions used in the model were:

	<u>2009</u>	<u>2008</u>
Risk-free interest rate	1.11%	2.30%

Expected stock volatility	31.30%	20.70%
Expected life	3 years	3 years

### Stock Options

Under the Plans, stock options may also be granted with an option exercise price per share not less than the fair market value of PPL's common stock on the date of grant. The options are exercisable in installments beginning one year after the date of grant, assuming the individual is still employed by PPL or a subsidiary. Options outstanding at December 31, 2009, become exercisable in equal installments over a three-year period from the date of grant. The CGNC and CLC have discretion to accelerate the exercisability of the options, except that the exercisability of an option issued under the ICP may not be accelerated unless the individual remains employed by PPL or a subsidiary for one year from the date of grant. All options expire no later than ten years from the grant date. The options become exercisable immediately if control of PPL changes, as defined by the Plans.

Stock option activity for 2009 was:

	<u>Number of Options</u>	<u>Weighted-Average Exercise Price</u>	<u>Weighted-Average Remaining Contractual Term</u>	<u>Aggregate Total Intrinsic Value</u>
<b>PPL</b>				
Outstanding at beginning of period	4,027,371	\$ 32.56		
Granted	1,053,320	31.86		
Exercised	(137,840)	22.15		
Forfeited	(340,810)	34.12		
Outstanding at end of period	4,602,041	32.59	6.8	\$ 11
Options exercisable at end of period	2,968,551	30.73	5.8	11
<b>PPL Energy Supply</b>				
Outstanding at beginning of period	1,434,356	\$ 32.05		
Granted	262,770	31.83		
Exercised	(46,900)	19.56		
Forfeited	(241,290)	34.20		
Outstanding at end of period	1,408,936	32.05	6.3	\$ 4
Options exercisable at end of period	1,022,909	32.84	6.2	4
<b>PL Electric</b>				
Outstanding at beginning of period	146,120	\$ 36.09		
Granted	79,550	32.22		
Outstanding at end of period	225,670	34.72	7.1	
Options exercisable at end of period	100,388	29.05	5.4	

Substantially all stock option awards are expected to vest.

The estimated fair value of each option granted was calculated using a Black-Scholes option-pricing model. PPL uses historical volatility and exercise behavior to value its stock options. Volatility over the expected term of the options is evaluated with consideration given to prior periods that may need to be excluded based on events not likely to recur that had impacted PPL's volatility in those prior periods. Management's expectations for future volatility, considering potential changes to PPL's business model and other economic conditions, are also reviewed in addition to the historical data to determine the final volatility assumption. The weighted-average assumptions used in the model were:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Risk-free interest rate	2.07%	2.95%	4.85%
Expected option life	5.25 years	5.41 years	6.00 years
Expected stock volatility	26.06%	20.85%	21.61%
Dividend yield	3.48%	3.10%	3.31%

The weighted-average grant date fair values of options granted were:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
PPL	5.55	7.61	7.08
PPL Energy Supply	5.55	7.62	7.08
PL Electric	5.65	7.60	7.08

The total intrinsic value of stock options exercised was:

Year Ended December 31,

	<u>2009</u>		<u>2008</u>		<u>2007</u>
PPL	\$	2	\$	20	\$ 54
PPL Energy Supply		1		7	13
PL Electric				2	3

At December 31, 2009, unrecognized compensation cost related to stock options was:

	<u>Unrecognized Compensation Cost</u>	<u>Weighted-Average Period for Recognition</u>
PPL	\$ 3	1.8 years
PPL Energy Supply	1	1.9 years

At December 31, 2009, PPL Electric's unrecognized compensation cost was insignificant and the weighted-average period for recognition was 1.9 years.

PPL received cash from stock option exercises during 2009 of \$3 million.

### Compensation Costs

Compensation costs for restricted stock, restricted stock units, performance units and stock options accounted for as equity awards were as follows:

	<u>2009</u>		<u>2008</u>		<u>2007</u>
PPL (a)	\$	23	\$	28	\$ 26
PPL Energy Supply (b)		17		22	21
PPL Electric (c)		5		6	5

(a) Net of an income tax benefit of \$9 million, \$11 million and \$10 million.

(b) Net of an income tax benefit of \$7 million, \$9 million and \$9 million.

(c) Net of an income tax benefit of \$2 million for each year.

The income tax benefit PPL realized from stock-based arrangements for 2009 was insignificant.

### Directors Stock Units (PPL)

Under the Directors Deferred Compensation Plan, a mandatory amount of the cash retainers of the members of the Board of Directors who are not employees of PPL is deferred into stock units. Such deferred stock units represent the number of shares of PPL's common stock to which the board members are entitled after they cease serving as a member of the Board of Directors. Board members are entitled to defer any or all of their fees and cash retainers that are not part of the mandatory deferral into stock units. The stock unit accounts of each board member are increased based on dividends paid or other distributions on PPL's common stock. There were 406,584 such stock units outstanding at December 31, 2009, which were accounted for as liabilities with changes in fair value recognized currently in earnings based on PPL's common stock price at the end of each reporting period.

	<u>Compensation Costs (Credits)</u>		
	<u>2009</u>	<u>2008</u>	<u>2007</u>
PPL (a)	\$ 2	\$ (4)	\$ 5

(a) Net of income tax benefit (expense) of \$1 million, \$(2) million and \$2 million.

Awards paid during 2009, 2008 and 2007 were insignificant.

### Stock Appreciation Rights (PPL and PPL Energy Supply)

WPD uses stock appreciation rights to compensate senior management employees. Stock appreciation rights are granted with a reference price to PPL's common stock at the date of grant. These awards vest over a three-year period and have a 10-year term, during which time employees are entitled to receive a cash payment of any appreciation in the price of PPL's common stock over the grant date fair value. At December 31, 2009, there were 416,891 stock appreciation rights outstanding, which are accounted for as liabilities with changes in fair value recognized currently in earnings based on updated Black-Scholes calculations.

Compensation costs related to stock appreciation rights in 2009 were insignificant. Compensation credits in 2008 were \$2 million, with related income tax expense of \$1 million. Compensation costs for 2007 were \$5 million, with related income tax benefits of \$2 million.

There were no awards exercised and paid in 2009. Awards paid in 2008 and 2007 were each \$2 million.

## 12. Retirement and Postemployment Benefits

(PPL, PPL Energy Supply and PPL Electric)

### Defined Benefits

PPL and certain of its subsidiaries sponsor various defined benefit plans.

The majority of PPL's domestic employees are eligible for pension benefits under non-contributory defined benefit pension plans with benefits based on length of service and final average pay, as defined by the plans. Certain employees may also be eligible for pension enhancements in the form of special termination benefits under PPL's separation plan. See "Separation Benefits" below for additional information regarding PPL's separation plan.

Employees of PPL Montana are eligible for pension benefits under a cash balance pension plan and employees of certain of PPL's mechanical contracting companies are eligible for benefits under multi-employer plans sponsored by various unions. The employees of WPD are eligible for pension benefits under a defined benefit pension plan with benefits based on length of service and final average pay.

PPL and certain of its subsidiaries also provide supplemental retirement benefits to executives and other key management employees through unfunded nonqualified retirement plans.

The majority of employees of PPL's domestic subsidiaries will become eligible for certain health care and life insurance benefits upon retirement through contributory plans. Postretirement benefits under the PPL Retiree Health Plan are paid from funded VEBA trusts sponsored by PPL Services and a 401(h) account established within the PPL Services pension master trust by the respective companies. Postretirement benefits under the PPL Montana Retiree Health Plan are paid from company assets. WPD does not sponsor any postretirement benefit plans other than pensions.

The following disclosures distinguish between the domestic (U.S.) and WPD (U.K.) pension plans.

	Pension Benefits						Other Postretirement Benefits		
	U.S.			U.K.					
	2009	2008	2007	2009	2008	2007	2009	2008	2007
<b>PPL</b>									
<b>Net periodic defined benefit costs:</b>									
Service cost	\$ 60	\$ 62	\$ 63	\$ 9	\$ 16	\$ 24	\$ 6	\$ 8	\$ 8
Interest cost	145	140	132	156	188	170	29	33	31
Expected return on plan assets	(169)	(180)	(175)	(189)	(231)	(227)	(18)	(21)	(21)
Amortization of:									
Transition (asset) obligation	(5)	(4)	(4)				9	9	9
Prior service cost	19	20	19	4	5	5	9	9	9
Actuarial (gain) loss	3	(9)	2	2	18	55	2	5	6
Net periodic defined benefit costs (credits) prior to settlement charges and termination benefits	53	29	37	(18)	(4)	27	37	43	42
Settlement charges (a)	2		3						
Termination benefits (b)	9		6			3			
Net periodic defined benefit costs (credits)	\$ 64	\$ 29	\$ 46	\$ (18)	\$ (4)	\$ 30	\$ 37	\$ 43	\$ 42
<b>Other Changes in Plan Assets and Benefit Obligations Recognized in OCI and regulatory assets - Gross</b>									
Settlements	\$ (2)		\$ (3)						
Current year net (gain) loss	102	\$ 635	(137)	\$ 403	\$ 476	\$ (254)	\$ 32	\$ (31)	\$ (4)
Current year prior service cost (credit)	1		9				(4)	(2)	5
Amortization of:									
Transition asset (obligation)	5	4	4				(9)	(9)	(9)
Prior service cost	(19)	(22)	(19)	(4)	(5)	(5)	(8)	(9)	(9)
Actuarial loss	(3)	(1)	(2)	(2)	(18)	(55)	(2)	(9)	(6)
Total recognized in OCI and regulatory assets (c) (d)	84	616	(148)	397	453	(314)	9	(60)	(23)

Total recognized in net periodic



benefit costs, OCI and regulatory assets (d)	\$ 148	\$ 645	\$ (102)	\$ 379	\$ 449	\$ (284)	\$ 46	\$ (17)	\$ 19
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- (a) Includes the settlement of the pension plan of PPL's former mining subsidiary, PA Mines, LLC in 2009 and a non-qualified plan settlement in 2007.
- (b) The \$9 million U.S. cost of termination benefits in 2009 was related to a 2009 cost reduction initiative. The \$6 million U.S. and \$3 million U.K. costs of termination benefits for 2007 were related primarily to the elimination of positions at PPL's Martins Creek plant due to the shutdown of two coal-fired units in September 2007, and the closing of WPD's meter test station.
- (c) For PPL's U.S. pension and other post-retirement benefits the amounts recognized in OCI and regulatory assets are as follows:

	U.S. Pension Benefits			Other Postretirement Benefits		
	2009	2008	2007	2009	2008	2007
OCI	\$ 51	\$ 395	\$ (87)	\$ 6	\$ (38)	\$ (7)
Regulatory assets	33	221	(61)	3	(22)	(16)
Total recognized in OCI and regulatory assets	<u>\$ 84</u>	<u>\$ 616</u>	<u>\$ (148)</u>	<u>\$ 9</u>	<u>\$ (60)</u>	<u>\$ (23)</u>

- (d) WPD is not subject to accounting for the effects of certain types of regulation as prescribed by GAAP. As a result, WPD does not record regulatory assets.

The estimated amounts to be amortized from AOCI and regulatory assets into net periodic benefit costs in 2010 are as follows:

	Pension Benefits		Other Postretirement Benefits
	U.S.	U.K.	
Transition obligation			\$ 9
Prior service cost	\$ 19	\$ 4	7
Actuarial loss	3	52	5
Total	<u>\$ 22</u>	<u>\$ 56</u>	<u>\$ 21</u>
Amortization from Balance Sheet:			
OCI	\$ 15	\$ 56	\$ 13
Regulatory assets	7		8
Total	<u>\$ 22</u>	<u>\$ 56</u>	<u>\$ 21</u>

	Pension Benefits						Other Postretirement Benefits		
	U.S.			U.K.					
	2009	2008	2007	2009	2008	2007	2009	2008	2007
<b>PPL Energy Supply</b>									
<b>Net periodic defined benefit costs:</b>									
Service cost	\$ 4	\$ 4	\$ 4	\$ 9	\$ 16	\$ 24	\$ 1	\$ 1	\$ 1
Interest cost	6	6	6	156	188	170	1	1	1
Expected return on plan assets	(6)	(8)	(8)	(189)	(231)	(227)			
Amortization of:									
Prior service cost				4	5	5			
Actuarial loss	2			2	18	55			
Net periodic pension and postretirement costs (credits) prior to settlement charges and termination benefits	6	2	2	(18)	(4)	27	2	2	2
Settlement charges (a)	2								
Termination benefits (b)						3			
Net periodic defined benefit costs (credits)	<u>\$ 8</u>	<u>\$ 2</u>	<u>\$ 2</u>	<u>\$ (18)</u>	<u>\$ (4)</u>	<u>\$ 30</u>	<u>\$ 2</u>	<u>\$ 2</u>	<u>\$ 2</u>

**Other Changes in Plan Assets and Benefit Obligations Recognized in OCI**

Settlements	\$ (2)								
Current year net (gain) loss	4	\$ 27	\$ (7)	\$ 403	\$ 476	\$ (254)		\$ (1)	(1)
Current year prior service credit									
Amortization of:									
Prior service cost				(4)	(5)	(5)			

Actuarial loss	(2)		(2)	(18)	(55)			
Total recognized in OCI	27	(7)	397	453	(314)		(2)	
Total recognized in net periodic benefit cost and OCI	\$ 8	\$ 29	\$ (5)	\$ 379	\$ 449	\$ (284)	\$ 2	\$ 2

(a) Includes the settlement of the pension plan of PPL's former mining subsidiary, PA Mines, LLC in 2009.

(b) The \$3 million U.K. cost of termination benefits for 2007 was related to the closing of a WPD meter test station. In addition, severance of \$2 million was also recorded for a total charge of \$5 million (\$4 million after tax).

Prior service costs for PPL Energy Supply of \$4 million and actuarial loss of \$52 million related to the U.K. pension plans are expected to be amortized from AOCI into net periodic benefit costs in 2010.

Net periodic defined benefit costs (credits) charged to operating expense, excluding amounts charged to construction and other non-expense accounts, were:

	Pension Benefits						Other Postretirement Benefits		
	U.S.			U.K.			2009	2008	2007
	2009	2008	2007	2009	2008	2007			
PPL	\$ 56	\$ 24	\$ 40	\$ (17)	\$ (4)	\$ 27	\$ 31	\$ 36	\$ 35
PPL Energy Supply (a)	26	10	19	(17)	(4)	27	14	16	16
PPL Electric (b)	14	5	7				10	13	10

(a) In addition to the specific plans it sponsors, PPL Energy Supply and its subsidiaries are also allocated costs of defined benefit plans sponsored by PPL Services, included in the total cost above, based on their participation in those plans.

(b) PPL Electric does not directly sponsor any defined benefit plans. PPL Electric was allocated these costs of defined benefit plans sponsored by PPL Services, based on its participation in those plans.

The following weighted-average assumptions were used in the valuation of the benefit obligations at December 31.

	Pension Benefits						Other Postretirement Benefits		
	U.S.			U.K.			2009	2008	2007
	2009	2008	2007	2009	2008	2007			
<b>PPL</b>									
Discount rate	6.00%	6.50%	6.39%	5.55%	7.47%	6.37%	5.81%	6.45%	6.26%
Rate of compensation increase	4.75%	4.75%	4.75%	4.00%	4.00%	4.25%	4.75%	4.75%	4.75%
<b>PPL Energy Supply</b>									
Discount rate	6.00%	6.50%	6.39%	5.55%	7.47%	6.37%	5.55%	6.37%	6.13%
Rate of compensation increase	4.75%	4.75%	4.75%	4.00%	4.00%	4.25%	4.75%	4.75%	4.75%

The following weighted-average assumptions were used to determine the net periodic benefit costs for the year ended December 31.

	Pension Benefits						Other Postretirement Benefits		
	U.S.			U.K.			2009	2008	2007
	2009	2008	2007	2009	2008	2007			
<b>PPL</b>									
Discount rate	6.50%	6.39%	5.94%	7.47%	6.37%	5.17%	6.45%	6.26%	5.88%
Rate of compensation increase	4.75%	4.75%	4.75%	4.00%	4.25%	4.00%	4.75%	4.75%	4.75%
Expected return on plan assets (a)	8.00%	8.25%	8.50%	7.90%	7.90%	8.09%	7.00%	7.80%	7.75%
<b>PPL Energy Supply</b>									
Discount rate	6.50%	6.39%	5.94%	7.47%	6.37%	5.17%	6.37%	6.13%	5.79%
Rate of compensation increase	4.75%	4.75%	4.75%	4.00%	4.25%	4.00%	4.75%	4.75%	4.75%
Expected return on plan assets (a)	7.78%	8.04%	8.27%	7.90%	7.90%	8.09%	N/A	N/A	N/A

(a) The expected long-term rates of return for PPL and PPL Energy Supply's U.S. pension and other postretirement benefits have been developed using a best-estimate of expected returns, volatilities and correlations for each asset class. The best estimates are based on

historical performance, future expectations and periodic portfolio rebalancing among the diversified asset classes. PPL management corroborates these rates with expected long-term rates of return calculated by its independent actuary, who uses a building block approach that begins with a risk-free rate of return with factors being added such as inflation, duration, credit spreads and equity risk. Each plan's specific asset allocation is also considered in developing a reasonable return assumption.

The expected long-term rates of return for PPL and PPL Energy Supply's U.K. pension plans have been developed by WPD management with assistance from an independent actuary using a best-estimate of expected returns, volatilities and correlations for each asset class. The best estimates are based on historical performance, future expectations and periodic portfolio rebalancing among the diversified asset classes.

	<b>Assumed Health Care Cost Trend Rates at December 31,</b>		
	<b>2009</b>	<b>2008</b>	<b>2007</b>
<b>PPL and PPL Energy Supply</b>			
Health care cost trend rate assumed for next year			
- obligations	8.0%	8.4%	9.0%
- cost	8.4%	9.0%	9.0%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)			
- obligations	5.5%	5.5%	5.5%
- cost	5.5%	5.5%	5.5%
Year that the rate reaches the ultimate trend rate			
- obligations	2016	2014	2014
- cost	2014	2014	2012

A one percentage point change in the assumed health care costs trend rate assumption would have had the following effects on the other postretirement benefit plans in 2009.

	<b>One Percentage Point</b>	
	<b>Increase</b>	<b>Decrease</b>
<b>PPL</b>		
Effect on service cost and interest cost components	\$ 1	\$ (1)
Effect on accumulated postretirement benefit obligation	14	(12)

The effects on PPL Energy Supply's other postretirement benefit plans would not have been significant.

(PPL)

The funded status of the PPL plans was as follows.

	<b>Pension Benefits</b>				<b>Other Postretirement Benefits</b>	
	<b>U.S.</b>		<b>U.K.</b>			
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
<b>Change in Benefit Obligation</b>						
Benefit Obligation, beginning of period	\$ 2,231	\$ 2,189	\$ 2,152	\$ 3,295	\$ 451	\$ 541
Service cost	60	62	9	15	6	8
Interest cost	145	140	156	188	29	33
Participant contributions			5	7	6	8
Plan amendments	1				(4)	(2)
Actuarial (gain) loss	125	(13)	611	(411)	43	(94)
Termination benefits	9					
Actual expenses paid	(1)	(1)				
Gross benefits paid	(104)	(95)	(189)	(180)	(36)	(36)
Settlements (b)	(6)					
Federal subsidy					3	2
Currency conversion			189	(762)		
Divestiture (a)		(51)				(9)
Benefit Obligation, end of period	<u>2,460</u>	<u>2,231</u>	<u>2,933</u>	<u>2,152</u>	<u>498</u>	<u>451</u>
<b>Change in Plan Assets</b>						
Plan assets at fair value, beginning of period	1,637	2,212	1,842	3,388	267	291
Actual return on plan assets	192	(469)	427	(770)	28	(42)
Employer contributions	54	29	95	92	33	38
Participant contributions			5	7	6	12
Actual expenses paid	(1)	(1)				
Gross benefits paid	(104)	(95)	(189)	(179)	(33)	(32)
Settlements (a)	(6)					

Currency conversion			151	(696)		
Divestiture (b)		(39)				
Plan assets at fair value, end of period	1,772	1,637	2,331	1,842	301	267
Funded Status, end of period	\$ (688)	\$ (594)	\$ (602)	\$ (310)	\$ (197)	\$ (184)

**Amounts recognized in the Balance**

<b>Sheets consist of:</b>						
Current liability	\$ (7)	\$ (5)			\$ (1)	\$ (1)
Noncurrent liability	(681)	(589)	(602)	(310)	(196)	(183)
Net amount recognized, end of period	\$ (688)	\$ (594)	\$ (602)	\$ (310)	\$ (197)	\$ (184)

**Amounts recognized in AOCI and regulatory assets (pre-tax) consist of:**

<b>(c)</b>						
Transition (asset) obligation		\$ (4)			\$ 26	\$ 35
Prior service cost	\$ 120	139	13	16	31	43
Net actuarial loss	398	300	1,126	726	101	70
Total	\$ 518	\$ 435	\$ 1,139	\$ 742	\$ 158	\$ 148

**Total accumulated benefit obligation for defined benefit pension plans**

\$ 2,237	\$ 1,999	\$ 2,806	\$ 2,058
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- (a) Includes the settlement of the pension plan of PPL's former mining subsidiary, PA Mines LLC in 2009.  
(b) Includes the pension and postretirement medical plans related to the gas and propane businesses that were sold in 2008. See Note 9 for additional information.  
(c) For PPL's U.S. pension and other post-retirement benefits, the amounts recognized in AOCI and regulatory assets are as follows:

	U.S. Pension Benefits		Other Postretirement Benefits	
	2009	2008	2009	2008
	AOCI	\$ 346	\$ 295	\$ 95
Regulatory assets	172	140	63	59
Total	\$ 518	\$ 435	\$ 158	\$ 148

All of PPL's pension plans had projected and accumulated benefit obligations in excess of plan assets at December 31, 2009 and 2008. All of PPL's other postretirement benefit plans had accumulated postretirement benefit obligations in excess of plan assets at December 31, 2009 and 2008.

(PPL Energy Supply)

The funded status of the PPL Energy Supply plans was as follows.

	Pension Benefits				Other Postretirement Benefits	
	U.S.		U.K.		2009	2008
	2009	2008	2009	2008		
<b>Change in Benefit Obligation</b>						
Benefit Obligation, beginning of period	\$ 95	\$ 89	\$ 2,152	\$ 3,295	\$ 15	\$ 16
Service cost	4	4	9	15	1	1
Interest cost	6	6	156	188	1	1
Participant contributions			5	7		
Plan amendments						(1)
Actuarial (gain) loss	7	(2)	611	(411)		(1)
Settlements (a)	(6)					
Gross benefits paid	(2)	(2)	(189)	(180)		(1)
Currency conversion			189	(762)		
Benefit Obligation, end of period	104	95	2,933	2,152	17	15
<b>Change in Plan Assets</b>						
Plan assets at fair value, beginning of period	78	100	1,842	3,388		
Actual return on plan assets	9	(20)	427	(770)		
Employer contributions	9		95	92		1
Participant contributions			5	7		

Gross benefits paid	(3)	(2)	(189)	(179)		(1)
Settlements (a)	(6)					
Currency conversion			151	(696)		
Plan assets at fair value, end of period	<u>87</u>	<u>78</u>	<u>2,331</u>	<u>1,842</u>		
Funded Status, end of period	<u>\$ (17)</u>	<u>\$ (17)</u>	<u>\$ (602)</u>	<u>\$ (310)</u>	<u>\$ (17)</u>	<u>\$ (15)</u>
<b>Amounts recognized in the Balance Sheets consist of:</b>						
Current liability					\$ (1)	\$ (1)
Noncurrent liability	<u>\$ (17)</u>	<u>\$ (17)</u>	<u>\$ (602)</u>	<u>\$ (310)</u>	<u>(16)</u>	<u>(14)</u>
Net amount recognized, end of period	<u>\$ (17)</u>	<u>\$ (17)</u>	<u>\$ (602)</u>	<u>\$ (310)</u>	<u>\$ (17)</u>	<u>\$ (15)</u>
<b>Amounts recognized in AOCI (pre-tax) consist of:</b>						
Prior service cost (credit)	\$ 2	\$ 2	\$ 13	\$ 16	\$ (1)	\$ (1)
Net actuarial loss	<u>30</u>	<u>30</u>	<u>1,126</u>	<u>726</u>	<u>4</u>	<u>4</u>
Total	<u>\$ 32</u>	<u>\$ 32</u>	<u>\$ 1,139</u>	<u>\$ 742</u>	<u>\$ 3</u>	<u>\$ 3</u>
<b>Total accumulated benefit obligation for defined benefit pension plans</b>	\$ 104	\$ 95	\$ 2,806	\$ 2,058		

(a) Includes the settlement of the pension plan of PPL Energy Supply's former mining subsidiary, PA Mines LLC in 2009.

All of PPL Energy Supply's pension plans had projected and accumulated benefit obligations in excess of plan assets at December 31, 2009 and 2008. All of PPL Energy Supply's other postretirement benefit plans had accumulated postretirement benefit obligations in excess of plan assets at December 31, 2009 and 2008.

In addition to the plans it sponsors, PPL Energy Supply and its subsidiaries are allocated a portion of the funded status and costs of the defined benefit plans sponsored by PPL Services based on their participation in those plans. PPL Energy Supply's allocated share of the funded status of the pension plans resulted in a liability of \$265 million and \$229 million at December 31, 2009 and 2008. PPL Energy Supply's allocated share of other postretirement benefits was a liability of \$74 million and \$69 million at December 31, 2009 and 2008.

PPL Energy Supply's subsidiaries engaged in the mechanical contracting business make contributions to various multi-employer pension and health and welfare plans, depending on an employee's status. Contributions were \$54 million in 2009 and \$61 million in both 2008 and 2007.

*(PPL Electric)*

Although PPL Electric does not directly sponsor any defined benefit plans, it is allocated a portion of the funded status and costs of plans sponsored by PPL Services based on its participation in those plans. PPL Electric's allocated share of the funded status of the pension plans resulted in a liability of \$245 million and \$209 million at December 31, 2009 and 2008. PPL Electric's allocated share of other postretirement benefits was a liability of \$73 million and \$69 million at December 31, 2009 and 2008.

*(PPL and PPL Electric)*

PPL Electric maintains a liability for the cost of health care of retired miners of former subsidiaries that had been engaged in coal mining, as required by the Coal Industry Retiree Health Benefit Act of 1992. However, total obligations of \$59 million are offset by assets in a retired miners VEBA fund and excess Black Lung Trust assets.

#### **Plan Assets - U.S. Pension Plans** *(PPL and PPL Energy Supply)*

PPL and PPL Energy Supply's U.S. pension plans are invested in a master trust that also includes a 401(h) account that is restricted for certain other postretirement benefit obligations. The investment strategy for the master trust is to achieve a risk-adjusted return on a mix of assets that, in combination with PPL's funding policy and tolerance for return volatility, will ensure that sufficient assets are available to provide long-term growth and liquidity for benefit payments. The master trust benefits from a wide diversification of asset types, investment fund strategies and external investment fund managers, and therefore has no significant concentration of risk.

The investment policies of the U.S. pension plans outline allowable investments and define the responsibilities of the internal pension administrative committee and the external investment managers. The only prohibited investments are investments in debt or equity securities issued by PPL and its subsidiaries or PPL's pension plan consultant. The investment policies are reviewed and approved annually by PPL's Board of Directors.

Target allocation ranges have been developed based on input from external consultants with a goal of limiting funded status volatility. The assets in the U.S. pension plans are rebalanced as necessary to maintain the target asset allocation ranges. The asset allocation for the master

trust and the target allocation, by asset class, at December 31 are detailed below.

Asset Class	Percentage of plan assets		Target Range	Target Asset Allocation
	2009	2008	2009	2009
Equity securities				
U.S.	31%	37%	18-32%	25%
International	19%	15%	10-24%	17%
Debt securities and derivatives	38%	41%	31-45%	38%
Alternative investments	8%	5%	8-22%	15%
Cash and cash equivalents	4%	2%	0-12%	5%
Total	100%	100%		100%

U.S. equity securities include investments in large-cap and small-cap companies. International equity securities include investments in developed markets and emerging markets. The investments in U.S. and international equity securities include investments in individual securities and investments in commingled funds. Investments in debt securities include U.S. Treasuries, U.S. government agencies, residential mortgage-backed securities, asset-backed securities, investment-grade corporate bonds, high-yield corporate bonds, municipal bonds and international debt securities. Alternative investments include investments in real estate, private equity funds and hedge fund of funds that follow several different strategies. Derivative instruments are utilized as a cost-effective means to mitigate risk and match the duration of investments to projected obligations.

(PPL)

The fair value of net assets in the U.S. pension plans by asset class and level within the fair value hierarchy was:

	December 31, 2009			
	Total	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
Cash and cash equivalents	\$ 90	\$ 90		
Equity securities:				
U.S.:				
Large-cap (a)	511	361	\$ 150	
Small-cap (b)	84	84		
International:				
Developed markets (c)	327	205	122	
Emerging markets (d)	71	9	62	
Debt securities:				
U.S.:				
U.S. Treasury	212	212		
U.S. government agency	6		6	
Residential mortgage-backed (e)	50		48	\$ 2
Asset-backed (f)	9		9	
Investment-grade corporate (g)	191		189	2
High-yield corporate (h)	92		84	8
Other				
International (i)	5		5	
Alternative investments:				
Real estate (j)	65		65	
Private equity (k)	6			6
Hedge fund of funds (l)	64		64	
Derivatives:				
Foreign currency forward contracts (m)	1		1	
To-be-announced (TBA) debt securities (n)	10			10
Interest rate swaps	(4)		(4)	
Receivables (o)	15	8	7	
Payables (p)	(22)	(22)		
Total master trust assets	1,783	947	808	28
401(h) account restricted for other postretirement benefit obligations	(11)	(6)	(5)	
Fair value - U.S. pension plans	\$ 1,772	\$ 941	\$ 803	\$ 28

- (a) Represents actively and passively managed investments that are measured against various U.S. equity indices.
- (b) Represents actively managed investments in small-cap growth companies that are measured against the Russell 2000 Growth Index.
- (c) Represents actively managed investments that are measured against the MSCI EAFE Index.
- (d) Represents actively managed investments that are measured against the MSCI Emerging Markets Index.

- (e) Represents investments in securities issued by U.S. agencies and securitized by residential mortgages.
- (f) Represents investments securitized by auto loans, credit cards and other pooled loans.
- (g) Represents investments in investment grade bonds issued by U.S. companies across several industries.
- (h) Represents investments in non-investment grade bonds issued by U.S. companies across several industries.
- (i) Represents investments in debt securities issued by foreign governments and corporations.
- (j) Represents an investment in a real estate fund through a partnership that invests in core U.S. real estate properties diversified geographically and across major property types (e.g., office, industrial, retail, etc). The manager is focused on properties with high occupancy rates with quality tenants. This results in a focus on high income and stable cash flows with appreciation being a secondary factor. Core real estate generally has a lower degree of leverage when compared to more speculative real estate investing strategies.
- (k) Represents investments through partnerships in multiple early-state venture capital funds and private equity fund of funds that use diverse investment strategies.
- (l) Represents investments in hedge fund of funds that follow a number of different investment strategies to create a well-diversified portfolio.
- (m) Represents contracts utilized to mitigate foreign currency risk associated with anticipated foreign denominated cash receipts and payments.
- (n) Represents commitments to purchase debt securities. Used as a cost effective means of managing the duration of assets in the trust.
- (o) Represents interest and dividends earned but not received (Level 2) as well as investments sold but not yet settled (Level 1).
- (p) Represents costs incurred but not yet paid (Level 2) and investments purchased but not yet settled (Level 1).

A reconciliation of master trust assets classified as Level 3 at December 31, 2009 is as follows.

	<u>Residential mortgage backed securities</u>	<u>Investment- grade corporate debt</u>	<u>High-yield corporate debt</u>	<u>Private equity</u>	<u>TBA Debt Securities</u>	<u>Total</u>
Balance at beginning of period	\$ 4	\$ 3	\$ 4	\$ 5	\$ 51	\$ 67
Actual return on plan assets						
Relating to assets still held at the reporting date	(1)		1		1	1
Relating to assets sold during the period	1		(1)	(2)	(1)	(3)
Purchases, sales and settlements	(2)	(1)	4	3	(41)	(37)
Transfers into and/or (out of) Level 3						
Balance at end of period	<u>\$ 2</u>	<u>\$ 2</u>	<u>\$ 8</u>	<u>\$ 6</u>	<u>\$ 10</u>	<u>\$ 28</u>

The fair value measurements of cash and cash equivalents are based on amounts on deposit. The fair value measurements of equity securities (excluding commingled funds), which are generally classified as Level 1, are based on quoted prices in active markets. The fair value measurements of investments in commingled funds, which are classified as Level 2 and categorized as equity securities, are based on firm quotes of net asset values per share, which are not considered quoted prices in active markets. The fair value measurements of debt securities are generally based on evaluated prices that reflect observable market information, such as actual trade information for identical securities or for similar securities, adjusted for observable differences. When this information is not available, the fair value of debt securities is measured using present value techniques, which incorporate other observable inputs including interest rates for debt securities with credit ratings and terms to maturity similar to the debt securities being measured. When these inputs are not observable, the fair value of debt securities is classified as Level 3. The fair value measurements of derivative instruments utilize various inputs that include quoted prices for similar contracts or market-corroborated inputs. In certain instances when observable market prices are not available, these instruments may be valued using models with market observable inputs including forward prices and interest rates, among others.

The U.S. pension plans hold alternative investments including investments in real estate, private equity and hedge fund of funds.

- Real estate - Represents an investment in a partnership whose purpose is to manage investments in U.S. real estate. The partnership has limitations on the amounts that may be redeemed based on available cash to fund redemptions. Additionally, the general partner may decline to accept redemptions when necessary to avoid adverse consequences for the partnership, including legal and tax implications, among others. The fair value of the investment is based upon a partnership unit value.
- Private equity - Represents interests in partnerships that invest across industries using a number of diverse investment strategies. Two of the partnerships have limited lives of ten years, while the third has a life of 15 years, after which the master trust will receive liquidating distributions. Prior to the end of each partnership's life, the master trust's investment can not be redeemed with the partnership; however, the interest may be sold to other parties, subject to the general partner's approval. The master trust has unfunded commitments of \$56 million that may be required during the lives of the partnerships. Fair value is based on an ownership interest in partners' capital to which a proportionate share of net assets is attributed.
- Hedge fund of funds - Represents investments in two hedge fund of funds each with a different investment objective. Generally, shares may be redeemed on 90 days prior written notice. Both funds are subject to short term lockups and have limitations on the amount that may be withdrawn based on a percentage of the total net asset value of the fund, among other restrictions. All withdrawals are subject to the general partner's approval. Major investment strategies for both hedge fund of funds include long/short equity, market neutral, distressed debt, and relative value. One fund's fair value has been estimated using the net asset value per share and the other fund's fair value is based on an ownership interest in partners' capital to which a proportionate share of net assets is attributed.

(PPL Energy Supply)

PPL Montana, a subsidiary of PPL Energy Supply, has a pension plan whose assets are solely invested in the master trust, which is fully

disclosed by PPL (above). The fair value of this plan's assets of \$87 million at December 31, 2009 represents a 4.9% undivided interest in each asset and liability of PPL's master trust, including each asset whose fair value measurement was determined using significant unobservable inputs (Level 3).

#### Plan Assets - U.S. Other Postretirement Benefit Plans (PPL)

PPL's investment strategy with respect to its other postretirement benefit obligations is to fund VEBA trusts and a 401(h) account with voluntary contributions and to invest in a tax efficient manner. Excluding the 401(h) account included in the master trust, discussed in the U.S. Pensions Plans section above, PPL's other postretirement benefit plans are invested in a mix of assets for long-term growth with an objective of earning returns that provide liquidity as required for benefit payments. These plans benefit from diversification of asset types, investment fund strategies and investment fund managers and therefore have no significant concentration of risk. The only prohibited investments are investments in debt or equity securities issued by PPL and its subsidiaries. Equity securities include investments in domestic large-cap commingled funds. Securities issued by commingled funds that invest entirely in debt securities are traded as equity units, but treated by PPL as debt securities for asset allocation and target allocation purposes. Securities issued by commingled money market funds that invest entirely in money market securities are traded as equity units, but treated by PPL as cash and cash equivalents for asset allocation and target allocation purposes. The asset allocation for the VEBA trusts and the target allocation, by asset class, at December 31, are detailed below.

Asset Class	Percentage of plan assets		Permitted Range	Target Asset Allocation
	2009	2008		
U.S. equity securities	54%	43%	45-65%	55%
Debt securities (a)	37%	45%	30-50%	40%
Cash and cash equivalents (b)	9%	12%	0-15%	5%
Total	100%	100%		100%

(a) Includes commingled debt funds and debt securities.

(b) Includes commingled money market fund.

The fair value of assets in the U.S. other postretirement benefit plans by asset class and level within the fair value hierarchy was:

	December 31, 2009			
	Total	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
U.S. equity securities:				
Large-cap (a)	\$ 156		\$ 156	
Commingled debt (b)	61		61	
Commingled money market funds	26		26	
Debt securities:				
Municipalities (c)	46		46	
Receivables (d)	1		1	
Total VEBA trust assets	290		290	
401(h) account assets in master trust	11	\$ 6	5	
Fair value - U.S. other postretirement benefit plans	\$ 301	\$ 6	\$ 295	

(a) Represents investments in passively managed equity index funds that are measured against the S&P 500 Index.

(b) Represents investments in passively managed commingled funds invested in obligations of the U.S. Treasury.

(c) Represents investments in a diverse mix of tax-exempt municipal securities.

(d) Represents interest and dividends earned but not received as well as investments sold but not yet settled.

The fair value measurements of the domestic other postretirement benefit plan assets are based on the same inputs and measurement techniques used to measure the U.S. pension assets described above.

#### Plan Assets - U.K. Pension Plans (PPL and PPL Energy Supply)

The overall investment strategy of WPD's pension plans is developed by each plan's independent trustees in its Statement of Investment Principles in compliance with the U.K. Pensions Act of 1995 and other U.K. legislation. The trustees' primary focus is to ensure that assets are sufficient to meet members' benefits as they fall due with a longer term objective to reduce investment risk. The investment strategy is intended to maximize investment returns while not incurring excessive volatility in the funding position. WPD's plans are invested in a wide diversification of asset types, fund strategies and fund managers and therefore have no significant concentration of risk. Equity securities primarily include investments in U.K. and other international large and mid-cap companies. Commingled funds that consist entirely of debt securities are traded as equity units, but treated by WPD as debt securities for asset allocation and target allocation purposes. These include investments in U.K. corporate bonds and U.K. gilts. Debt securities include corporate bonds of companies from diversified U.K. industries. The only alternative investment is an investment in a real estate fund.



The asset allocation and target allocation at December 31 of WPD's pension plans are detailed below.

Asset Class	Percentage of plan assets		Target Asset Allocation
	2009	2008	2009
Equity securities:			
U.K. companies	22%	25%	18%
European companies (excluding the U.K.)	13%	11%	12%
Asian-Pacific companies	10%	10%	10%
North American companies	6%	7%	9%
Emerging markets companies	5%	1%	5%
Currency	2%	2%	2%
Global Tactical Asset Allocation	1%	1%	3%
Debt securities (a)	35%	37%	33%
Alternative investments and cash	6%	6%	8%
Total	100%	100%	100%

(a) Includes commingled debt funds.

The fair value of assets in the U.K. pension plans by asset class and level within the fair value hierarchy was:

	December 31, 2009			
	Total	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
Cash and cash equivalents	\$ 5	\$ 5		
Equity securities:				
U.K. companies (a)	501		\$ 501	
European companies (excluding the U.K.) (b)	290		290	
Asian-Pacific companies (c)	242		242	
North American companies (d)	149		149	
Emerging markets companies (e)	110		110	
Currency (f)	42		42	
Global Tactical Asset Allocation (g)	30		30	
Commingled debt:				
U.K. corporate bonds	308		308	
U.K. gilts	24		24	
U.K. index-linked gilts	489		489	
Alternative investments:				
Real estate (h)	141		141	
Fair value - international pension plans	\$ 2,331	\$ 5	\$ 2,326	

- (a) Represents passively managed equity index funds that are measured against the FTSE All Share Index.
- (b) Represents passively managed equity index funds that are measured against the FTSE Europe ex UK Index.
- (c) Represents an actively managed equity index fund that aims to outperform 50% FTSE Asia Pacific ex-Japan Index and 50% FTSE Japan Index.
- (d) Represents passively managed equity index funds that are measured against the FTSE North America Index.
- (e) Represents passively managed equity index funds that are measured against the MSCI Emerging Markets Index.
- (f) Represents investments in unitized passive and actively traded currency funds.
- (g) The Global Tactical Asset Allocation investment strategy attempts to benefit from short-term market inefficiencies by taking positions in worldwide markets with the objective to profit from relative movements across those markets.
- (h) Represents investments in a unitized fund that owns and manages U.K. industrial and commercial real estate with a strategy of earning current rental income and achieving capital growth.

Except for investments in real estate, the fair value measurements of WPD's pension plan assets are based on the same inputs and measurement techniques used to measure the U.S. pension assets described above.

Investments in real estate represent holdings in a U.K. unitized fund whose fair value is based upon a net asset value per share. The fund's net asset value is based on the value of underlying properties that are independently appraised in accordance with Royal Institution of Chartered Surveyors valuation standards at least annually with quarterly valuation updates based on recent sales of similar properties, leasing levels, property operations and/or market conditions. The fund may be subject to redemption restrictions in the unlikely event of a large forced sale in order to ensure other unit holders are not disadvantaged.

#### Expected Cash Flows - U.S. Defined Benefit Plans (PPL)

There are no cash contributions required for PPL's primary U.S. pension plan because contribution requirements could be satisfied by applying prior year credit balances. However, PPL contributed \$120 million to its primary U.S. pension plan in January 2010 to ensure future compliance with minimum funding requirements.

PPL sponsors various non-qualified supplemental pension plans for which no assets are segregated from corporate assets. PPL expects to make approximately \$4 million of benefit payments under these plans in 2010.

PPL is not required to make contributions to its other postretirement benefit plans but has historically funded these plans in amounts equal to the postretirement benefit costs recognized. Continuation of this past practice would cause PPL to contribute \$34 million to its other postretirement benefit plans in 2010.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid and the following federal subsidy payments are expected to be received by the separate plan trusts.

	<u>Pension</u>	<u>Other Postretirement</u>	
		<u>Benefit Payment</u>	<u>Expected Federal Subsidy</u>
2010	\$ 115	\$ 42	\$ 3
2011	123	47	3
2012	131	50	3
2013	145	55	4
2014	148	60	4
2015 - 2019	897	359	28

*(PPL Energy Supply)*

There are no contributions expected or required for the PPL Montana pension plan.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid by the separate plan trusts.

	<u>Pension</u>		<u>Other Postretirement</u>	
	2010	\$	2	\$
2011		3		2
2012		4		2
2013		4		2
2014		5		2
2015 - 2019		36		13

**Expected Cash Flows - U.K. Pension Plans** *(PPL and PPL Energy Supply)*

The pension plans of WPD are subject to formal actuarial valuations every three years, which are used to determine funding requirements. Future contributions were evaluated in accordance with the latest valuation performed as of March 31, 2007, in respect of WPD's principal pension scheme, to determine contribution requirements for 2009 and forward. WPD expects to make contributions of approximately \$62 million in 2010. WPD is currently permitted to recover in rates approximately 65% of its deficit funding requirements for its primary pension plan. This recovery rate will increase to 76% effective April 1, 2010.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid by the separate plan trusts.

	<u>Pension</u>	
2010	\$	161
2011		165
2012		170
2013		174
2014		179
2015 - 2019		974

*(PPL, PPL Energy Supply and PPL Electric)*

**Savings Plans**

Substantially all employees of PPL's domestic subsidiaries are eligible to participate in deferred savings plans (401(k)s). Employer contributions to the plans approximated the following.

<u>2009</u>	<u>2008</u>	<u>2007</u>
-------------	-------------	-------------

PPL	\$	17	\$	17	\$	16
PPL Energy Supply		10		9		9
PPL Electric		4		4		4

### Employee Stock Ownership Plan

PPL sponsors a non-leveraged ESOP in which substantially all domestic employees, excluding those of PPL Montana and the mechanical contractors, are enrolled on the first day of the month following eligible employee status. Dividends paid on ESOP shares are treated as ordinary dividends by PPL. Under existing income tax laws, PPL is permitted to deduct the amount of those dividends for income tax purposes and to contribute the resulting tax savings (dividend-based contribution) to the ESOP.

The dividend-based contribution is used to buy shares of PPL's common stock and is expressly conditioned upon the deductibility of the contribution for federal income tax purposes. Contributions to the ESOP are allocated to eligible participants' accounts as of the end of each year, based 75% on shares held in existing participants' accounts and 25% on the eligible participants' compensation.

Compensation expense for ESOP contributions was \$8 million in 2009 and \$7 million in 2008 and 2007. These amounts were offset by the dividend-based contribution tax savings and had no impact on PPL's earnings.

ESOP shares outstanding at December 31, 2009, were 7,691,540 or 2% of total common shares outstanding, and are included in all EPS calculations.

### Postemployment Benefits

Certain PPL subsidiaries provide health and life insurance benefits to disabled employees and income benefits to eligible spouses of deceased employees. Postemployment benefits charged to operating expenses were not significant for 2009, 2008 and 2007.

### Separation Benefits

Certain PPL subsidiaries provide separation benefits to eligible employees. These benefits may be provided in the case of separations due to performance issues, loss of job related qualifications or organizational changes. Certain employees separated are eligible for cash severance payments, outplacement services, accelerated stock award vesting, continuation of group health and welfare coverage, and enhanced pension and postretirement medical benefits. The type and amount of benefits provided is based upon age, years of service and the nature of the separation. Separation benefits are recorded when such amounts are probable and estimable.

In February 2009, PPL announced workforce reductions that resulted in the elimination of approximately 200 management and staff positions across PPL's domestic operations, or approximately 6% of PPL's non-union, domestic workforce. The charges noted below consisted primarily of enhanced pension and severance benefits under PPL's Pension Plan and Separation Policy and were recorded to "Other operation and maintenance" expense on the Statement of Income.

As a result of the workforce reductions, PPL recorded a charge of \$22 million (\$13 million after tax) in 2009.

PPL Energy Supply eliminated approximately 50 management and staff positions and recorded a charge of \$13 million (\$8 million after tax) in 2009. Included in this charge was \$8 million (\$4 million after tax) of allocated costs associated with the elimination of employees of PPL Services.

PPL Electric eliminated approximately 50 management and staff positions and recorded a charge of \$9 million (\$5 million after tax) in 2009. Included in this charge was \$3 million (\$1 million after tax) of allocated costs associated with the elimination of employees of PPL Services.

Separation benefits were not significant in 2008.

Separation benefits recorded in 2007 were related to the elimination of positions at PPL's Martins Creek plant due to the shutdown of two coal-fired units and the closing of WPD's meter test station. Total costs recorded were \$13 million (\$9 million after tax). These costs included \$4 million of cash severance payments and enhanced pension benefits provided to domestic employees of \$6 million and \$3 million provided to WPD employees. See "Defined Benefits" above for more information.

### 13. Jointly Owned Facilities

*(PPL and PPL Energy Supply)*

At December 31, 2009 and 2008, subsidiaries of PPL and PPL Energy Supply owned interests in the facilities listed below. The Balance Sheets of PPL and PPL Energy Supply include the amounts noted in the following table.

	<u>Ownership Interest</u>	<u>Electric Plant</u>	<u>Other Property</u>	<u>Accumulated Depreciation</u>	<u>Construction Work in Progress</u>
<b>December 31, 2009</b>					
<u>PPL Generation</u>					
Generating Stations					

Susquehanna	90.00%	\$	4,571	\$	3,475	\$	108
Conemaugh	16.25%		206		99		9
Keystone	12.34%		199		61		4
Merrill Creek Reservoir	8.37%			\$	22		15

**December 31, 2008**

**PPL Generation**

**Generating Stations**

Susquehanna	90.00%	\$	4,513	\$	3,472	\$	111
Conemaugh	16.25%		206		93		1
Keystone	12.34%		105		58		64
Wyman Unit 4 (a)	8.33%		15		7		
Merrill Creek Reservoir	8.37%			\$	22		14

(a) See Note 9 for information regarding the December 2009 sale of this interest.

In addition to the interests mentioned above, PPL Montana had a 50% leasehold interest in Colstrip Units 1 and 2 and a 30% leasehold interest in Colstrip Unit 3 under operating leases. See Note 10 for additional information. At December 31, 2009 and 2008, NorthWestern owned a 30% leasehold interest in Colstrip Unit 4. PPL Montana and NorthWestern have a sharing agreement to govern each party's responsibilities regarding the operation of Colstrip Units 3 and 4, and each party is responsible for 15% of the respective operating and construction costs, regardless of whether a particular cost is specified to Colstrip Unit 3 or 4.

Each PPL Generation subsidiary provides its own funding for its share of the facility. Each receives a portion of the total output of the generating stations equal to its percentage ownership. The share of fuel and other operating costs associated with the stations is included in the corresponding operating expenses on the Statements of Income.

**14. Commitments and Contingencies**

**Energy Purchases, Energy Sales and Other Commitments**

Energy Purchase Commitments

*(PPL and PPL Energy Supply)*

PPL and PPL Energy Supply enter into long-term purchase contracts to supply the fuel requirements for generation facilities. These contracts include commitments to purchase coal, emission allowances, limestone, natural gas, oil and nuclear fuel. These long-term contracts extend through 2019, excluding a limestone contract that extends through 2030. PPL and PPL Energy Supply also enter into long-term contracts for the storage and transportation of natural gas. The long-term natural gas storage contracts extend through 2015, and the long-term natural gas transportation contracts extend through 2032. Additionally, PPL and PPL Energy Supply have entered into long-term contracts to purchase power that extend through 2017, excluding long-term power purchase agreements for the full output of two wind farms that extend through 2027.

As part of the purchase of generation assets from Montana Power, PPL Montana assumed a power purchase and power sales agreement, which expires at December 31, 2010. In accordance with purchase accounting guidelines, PPL Montana recorded a liability of \$58 million as the fair value of the agreement at the acquisition date. The liability is being reduced over the term of the agreement as an adjustment to "Energy purchases" on the Statements of Income. At December 31, 2009, the \$11 million unamortized balance of this liability was included in "Other current liabilities" on the Balance Sheet. At December 31, 2008, the unamortized balance of this liability was \$24 million, of which \$13 million was included in "Other current liabilities" and \$11 million was included in "Other deferred credits and noncurrent liabilities" on the Balance Sheet.

In 1998, PPL Electric recorded an \$879 million loss accrual for above-market contracts with NUGs, due to deregulation of its generation business. Effective January 1999, PPL Electric began reducing this liability as an offset to "Energy purchases" on the Statements of Income. This reduction is based on the estimated timing of the purchases from the NUGs and projected market prices for this generation. The final NUG contract expires in 2014. In connection with PPL's corporate realignment in 2000, the remaining balance of this liability was transferred to PPL EnergyPlus. At December 31, 2009, the unamortized balance of this liability was \$4 million, of which \$1 million was included in "Other current liabilities" and \$3 million was included in "Other deferred credits and noncurrent liabilities" on the Balance Sheet. At December 31, 2008, the unamortized balance of this liability was \$29 million, of which \$25 million was included in "Other current liabilities" and \$4 million was included in "Other deferred credits and noncurrent liabilities" on the Balance Sheet.

In 2008, PPL EnergyPlus acquired the rights to an existing long-term tolling agreement associated with the capacity and energy of Ironwood. Under the agreement, PPL EnergyPlus has control over the plant's dispatch into the electricity grid and supplies the natural gas necessary to operate the plant. The tolling agreement extends through 2021. See Note 10 for additional information.

*(PPL and PPL Electric)*

From 2007 through October 2009, PPL Electric conducted six competitive solicitations to purchase electricity generation supply in 2010 for customers who do not choose an alternative supplier. Average generation supply prices (per MWh) for all six solicitations, including Pennsylvania gross receipts tax and an adjustment for line losses, were \$99.48 for residential customers and \$100.52 for small commercial and

small industrial customers.

In October 2009, PPL Electric purchased 2010 supply for fixed-price default service to large commercial and large industrial customers who elect to take that service. In November 2009, PPL Electric purchased supply to provide hourly default service to large commercial and industrial customers in 2010.

In June 2009, the PUC approved PPL Electric's plan to purchase its PLR electricity supply for January 2011 through May 2013. In August and October 2009, PPL Electric conducted the first two of its 14 planned competitive solicitations. A third solicitation was conducted in January 2010. The solicitations include a mix of long-term and short-term purchases for customer supply, including contracts for load-following, spot, block and alternative energy credits.

*(PPL Energy Supply and PPL Electric)*

See Note 15 for information on the power supply agreements between PPL EnergyPlus and PPL Electric.

#### Energy Sales Commitments

*(PPL and PPL Energy Supply)*

In connection with its marketing activities or hedging strategy for its power plants, PPL Energy Supply has entered into long-term power sales contracts that extend through 2023, excluding a long-term retail sales agreement for the full output from a solar generator that extends through 2034. All long-term contracts were executed at prices approximating market prices at the time of execution.

*(PPL Energy Supply and PPL Electric)*

See Note 15 for information on the power supply agreements between PPL EnergyPlus and PPL Electric.

#### PPL Montana Hydroelectric License Commitments *(PPL and PPL Energy Supply)*

PPL Montana owns and operates 11 hydroelectric facilities and one storage reservoir licensed by the FERC under long-term licenses pursuant to the Federal Power Act. Pursuant to Section 8(e) of the Federal Power Act, the FERC approved the transfer from Montana Power to PPL Montana of all pertinent licenses and any amendments in connection with the Montana Asset Purchase Agreement.

The Kerr Dam Project license (50-year term) was jointly issued by the FERC to Montana Power and the Confederated Salish and Kootenai Tribes of the Flathead Reservation in 1985, and requires Montana Power to hold and operate the project for 30 years (to 2015). The license requires Montana Power and PPL Montana, as successor to Montana Power, to continue to implement a plan to mitigate the impact of the Kerr Dam on fish, wildlife and their habitats. Under this arrangement, PPL Montana has a remaining commitment to spend \$12 million between 2010 and 2015, in addition to the annual rent it pays to the tribes. Between 2015 and 2025, the tribes have the option to purchase, hold and operate the project for the remainder of the license term, which expires in 2035.

PPL Montana entered into two Memoranda of Understanding (MOUs) with state, federal and private entities related to the issuance in 2000 of the FERC renewal license for the nine dams for the Missouri-Madison project. The MOUs are periodically updated and renewed and require PPL Montana to implement plans to mitigate the impact of its projects on fish, wildlife and their habitats, and to increase recreational opportunities. The MOUs were created to maximize collaboration between the parties and enhance the possibility to receive matching funds from relevant federal agencies. Under these arrangements, PPL Montana has a remaining commitment to spend \$36 million between 2010 and 2040.

#### **Legal Matters**

*(PPL, PPL Energy Supply and PPL Electric)*

PPL and its subsidiaries are involved in legal proceedings, claims and litigation in the ordinary course of business. PPL and its subsidiaries cannot predict the outcome of such matters, or whether such matters may result in material liabilities.

*(PPL and PPL Energy Supply)*

#### Montana Power Shareholders' Litigation

In August 2001, a purported class-action lawsuit was filed by a group of Montana Power shareholders against Montana Power, the directors of Montana Power, certain advisors and consultants of Montana Power, and PPL Montana. The plaintiffs allege, among other things, that Montana Power failed to obtain shareholder approval for the sale of Montana Power's generation assets to PPL Montana in 1999, and that the sale was null and void. Among the remedies sought by the plaintiffs is the establishment of a "resulting and/or constructive trust" on both the generation assets and all profits earned by PPL Montana from the generation assets, plus interest on the amounts subject to the trust. This lawsuit is pending in the U.S. District Court of Montana, Butte Division. Settlement discussions resumed in June 2009. A proposed settlement of this lawsuit has been reached under which plaintiffs will receive approximately \$115 million. Under the proposed settlement, PPL Montana is not required to pay any portion of this settlement amount. The proposed settlement was filed with the judge in November 2009 and is pending court approval. PPL and PPL Energy Supply cannot predict the outcome of this matter.

## Montana Hydroelectric Litigation

In November 2004, PPL Montana, Avista Corporation (Avista) and PacifiCorp commenced an action for declaratory judgment in Montana First Judicial District Court seeking a determination that no lease payments or other compensation for their hydroelectric facilities' use and occupancy of streambeds in Montana can be collected by the State of Montana. This request was brought following the dismissal on jurisdictional grounds of the State of Montana's federal lawsuit seeking such payments or compensation in the U.S. District Court of Montana, Missoula Division. The State's federal lawsuit was founded on allegations that the beds of Montana's navigable rivers became state-owned trust property upon Montana's admission to statehood, and that the use of them for placement of dam structures, affiliated structures and reservoirs should, under a 1931 regulatory scheme enacted after all but one of the dams in question were constructed, trigger lease payments for use of land beneath. In July 2006, the Montana state court approved a stipulation by the State of Montana that it is not seeking lease payments or other compensation from PPL Montana for the period prior to PPL Montana's December 1999 acquisition of the hydroelectric facilities.

In June and October 2007, Pacificorp and Avista, respectively, entered into settlement agreements with the State of Montana providing, in pertinent part, that each company would make prospective lease payments of \$50,000 and \$4 million per year for use of the State's navigable streambed (adjusted annually for inflation and subject to other future adjustments). Under these settlement agreements, the future annual payments resolved the State's claims for both past and future compensation.

In the October 2007 trial of this matter, the State of Montana asserted that PPL Montana should make a prospective lease payment for use of the State's streambeds of \$6 million per year (adjusted annually for inflation) and a retroactive compensation payment for the 2000-2006 period (including interest) of \$41 million. PPL Montana vigorously contested both such assertions.

In June 2008, the District Court issued a decision awarding compensation of approximately \$34 million for prior years and approximately \$6 million for 2007 compensation. The Court also deferred the determination of compensation for 2008 and future years to the Montana State Land Board.

PPL Montana believes that the District Court's decision and a number of its pretrial rulings are erroneous. In October 2008, PPL Montana filed an appeal of the decision to the Montana Supreme Court and a stay of judgment, including a stay of the Land Board's authority to assess compensation for 2008 and future periods. Oral argument of the case was held before the Montana Supreme Court in September 2009. For 2007 and subsequent years, PPL's management believes it is probable that its hydroelectric projects will be subject to annual estimated compensation ranging from \$3 million to \$6 million. PPL Montana's loss accrual at December 31, 2009 was \$9 million, of which \$8 million (\$5 million after tax or \$0.01 per share) was recorded in 2009. PPL Montana cannot predict the outcome of this matter.

## PJM/MISO Billing Dispute

*(PPL, PPL Energy Supply and PPL Electric)*

In September 2009, PJM reported that it had discovered a modeling error in the market-to-market power flow calculations between PJM and the Midwest ISO (MISO). The error was a result of incorrect modeling of certain generation resources that have an impact on power flows across the PJM/MISO border. PJM's preliminary estimate of the magnitude of the error is approximately \$77 million. To date, the MISO does not agree with PJM's estimate. Informal settlement discussions on this issue have commenced. PPL participates in markets in both the MISO and PJM. The amount and timing of any payment by PJM to the MISO relating to this modeling error is uncertain, as is the method by which PJM or the MISO would allocate any such payment to PJM and the MISO participants. PPL cannot predict the outcome of this matter; however, the impact on PPL subsidiaries is not expected to be material.

## **Regulatory Issues**

### Pennsylvania Activities (PPL and PPL Electric)

Certain Pennsylvania legislators proposed legislation in 2009 to extend PLR generation rate caps or otherwise limit cost recovery through rates for Pennsylvania utilities beyond their transition periods, which in PPL Electric's case was December 31, 2009. PPL and PPL Electric previously expressed strong concern regarding the adverse consequences of such legislation on customer service, system reliability, adequate future generation supply and PPL Electric's financial viability. As generation rate caps are set to expire for three other Pennsylvania electric delivery companies at the end of 2010, it is possible that a debate on rate caps, rate mitigation and the creation of a state power authority may resume in 2010. PPL and PPL Electric believe the enactment of legislation extending PPL Electric rate caps would be a violation of federal law and the U.S. Constitution.

For several years, PPL and PPL Electric worked with Pennsylvania legislators, regulators and others to develop programs to help customers transition to market rates after 2009, including rate mitigation, educational and energy conservation programs. Two plans were proposed and approved by the PUC. Under the first plan, residential and small commercial customers could elect to pay additional amounts with their electric bills from mid-2008 through 2009, with such additional amounts, plus accrued interest of 6%, applied to their 2010 and 2011 electric bills. Approximately 123,000 customers enrolled in the program, and at December 31, 2009, PPL Electric has recorded a liability of \$36 million related to this activity. Under the second plan, eligible residential and eligible small-business customers could elect to defer payment of any increase greater than 25% in their 2010 electric bills. Deferred amounts, plus 6% interest, will be paid by customers over a one- or two-year period, depending on their electricity use. All deferrals will be paid by the end of 2012.

Act 129 became effective in October 2008. The law creates an energy efficiency and conservation program and smart metering technology requirements, adopts new PLR electricity supply procurement rules, provides remedies for market misconduct, and makes changes to the existing Alternative Energy Portfolio Standard. The law also requires electric utilities to meet specified goals for reduction in customer

electricity usage and peak demand by specified dates. Utilities not meeting the requirements of Act 129 are subject to significant penalties.

Under Act 129, Electric Distribution Companies (EDCs) must develop and file an energy efficiency and conservation plan (EE&C Plan) with the PUC and contract with a conservation service provider to implement all or a portion of the EE&C Plan. Act 129 requires EDCs to cause reduced electricity consumption of 1% by 2011 and 3% by 2013, and reduced peak demand of 4.5% by 2013. EDCs will be able to recover the costs (capped at 2% of the EDC's 2006 revenue) of implementing their EE&C Plans. In October 2009, the PUC approved PPL Electric's EE&C Plan. The plan includes 14 programs, all of which are voluntary for customers. The plan includes a proposed rate mechanism for recovery of all costs incurred by PPL Electric to implement the plan.

Act 129 also requires installation of smart meters for new construction, upon the request of consumers at their cost, or on a depreciation schedule not exceeding 15 years. Under Act 129, EDCs will be able to recover the costs of providing smart metering technology. In August 2009, PPL Electric filed its proposed smart meter technology procurement and installation plan with the PUC. All of PPL Electric's metered customers currently have smart meters installed at their service locations and PPL Electric's current advanced metering technology generally satisfies the requirements of Act 129 and does not need to be replaced. PPL Electric's smart meter plan proposes to study, test and pilot applications to enhance and expand smart meter capabilities. PPL Electric estimates these studies will cost approximately \$62 million over the next five years. PPL Electric has proposed a rate mechanism for recovery of these costs. An Administrative Law Judge has issued a recommended decision generally approving PPL Electric's plan, but PPL Electric cannot predict whether the plan will be approved.

Act 129 also requires the default service provider (DSP) to provide electric generation supply service to customers pursuant to a PUC-approved competitive procurement plan through auctions, requests for proposal and bilateral contracts at the sole discretion of the DSP. Act 129 requires a mix of spot market purchases, short-term contracts and long-term contracts (4 to 20 years, with long-term contracts limited to up to 25% of the load unless otherwise approved by the PUC). The DSP will be able to recover the costs associated with a competitive procurement plan.

Under Act 129, the DSP competitive procurement plan must ensure adequate and reliable service "at least cost to customers" over time. Act 129 grants the PUC authority to extend long-term power contracts up to 20 years, if necessary, to achieve the "least cost" standard. The PUC has approved PPL Electric's procurement plan for the period January 1, 2011 through May 31, 2013 and PPL Electric has begun purchasing under that plan.

#### FERC Transmission Rates (PPL and PPL Electric)

In August 2008, PPL Electric asked the FERC to change the method for calculating its transmission rates to formula-based rates to support continued investment in its transmission system. Under formula-based rates, a fixed earnings level is set for the utility, and the utility annually adjusts its transmission rates, subject to FERC review, to reflect cost changes. The process offers an opportunity for public input. The proposed rate design prevents over-recovery or under-recovery of the actual costs of providing transmission delivery service. This request would not affect generation charges or distribution rates. PPL Electric requested that the proposed rate take effect November 1, 2008.

In October 2008, the FERC accepted the proposed rate for filing, effective November 1, 2008, subject to refund, and set the matter for hearing, but held the hearings in abeyance to establish settlement judge procedures. In May 2009, a settlement was reached by all interested parties which, among other things, reduced PPL Electric's return on equity to approximately 11.70%. PPL Electric was granted approval to implement the formula-based rate as established in the settlement, effective June 1, 2009. In August 2009, the FERC approved the settlement. See Note 1 for information on a true-up of these revenues.

#### California ISO and Western Markets (PPL and PPL Energy Supply)

Through its subsidiaries, PPL made \$18 million of sales to the California ISO during the period October 2000 through June 2001, \$17 million of which has not been paid to PPL subsidiaries. Given the myriad of electricity supply problems faced by California electric utilities and the California ISO, PPL cannot predict whether or when it will receive payment. At December 31, 2009, PPL continues to be fully reserved for non-payment for these sales.

Regulatory proceedings arising out of the California electricity supply controversy have been filed at the FERC. The FERC has determined that all sellers of energy into markets operated by the California ISO and the California Power Exchange, including PPL Montana, should be subject to refund liability for the period beginning October 2, 2000 through June 20, 2001, but the FERC has not yet ruled on the exact amounts that the sellers, including PPL Montana, would be required to refund. In decisions in September 2004 and August 2006, the U.S. Court of Appeals for the Ninth Circuit held that the FERC had the additional legal authority to order refunds for periods prior to October 2, 2000, and ordered the FERC to determine whether or not it would be appropriate to grant such additional refunds. In February 2008, the FERC initiated proceedings to determine whether it would be appropriate to grant additional refunds. In November 2009, the FERC issued an order scheduling evidentiary hearings in 2010 on such refunds but has suspended certain of these proceedings and instituted settlement procedures.

In June 2003, the FERC took several actions as a result of a number of related investigations. The FERC terminated proceedings to consider whether to order refunds for spot market bilateral sales made in the Pacific Northwest, including sales made by PPL Montana, during the period December 2000 through June 2001. In August 2007, the U.S. Court of Appeals for the Ninth Circuit reversed the FERC's decision and ordered the FERC to consider additional evidence. The FERC also commenced additional investigations relating to "gaming" and bidding practices during 2000 and 2001, but neither PPL EnergyPlus nor PPL Montana believes it is a subject of these investigations.

In February 2004, the Montana Public Service Commission initiated a limited investigation of the Montana retail electricity market for the years 2000 and 2001, focusing on how that market was affected by transactions involving the possible manipulation of the electricity grid in the western U.S. The investigation includes all public utilities and licensed electricity suppliers in Montana, including PPL Montana, as well as other entities that may possess relevant information. In June 2004, the Montana Attorney General served PPL Montana and more than 20 other

companies with subpoenas requesting documents, and PPL Montana has provided responsive documents to the Montana Attorney General.

While PPL and its subsidiaries believe that they have not engaged in any improper trading or marketing practices affecting the California and western markets, PPL cannot predict the outcome of the above-described investigations, lawsuits and proceedings or whether any PPL subsidiaries will be the target of any additional governmental investigations or named in other lawsuits or refund proceedings.

#### PJM RPM Litigation (PPL, PPL Energy Supply and PPL Electric)

In May 2008, a group of state public utility commissions, state consumer advocates, municipal entities and electric cooperatives, industrial end-use customers and a single electric distribution company (collectively, the RPM Buyers) filed a complaint before the FERC objecting to the prices for capacity under the PJM Reliability Pricing Model (RPM) that were set in the 2008-09, 2009-10 and 2010-11 RPM base residual auctions. The RPM Buyers requested that the FERC reset the rates paid to generators for capacity in those periods to a significantly lower level. Thus, the complaint requests that generators be paid less for those periods through refunds and/or prospective changes in rates. The relief requested in the complaint, if granted, could have a material effect on PPL, PPL Energy Supply and PPL Electric. PJM, PPL and numerous other parties have responded to the complaint, strongly opposing the relief sought by the RPM Buyers. In September 2008, the FERC entered an order denying the complaint. In August 2009, the RPM Buyers appealed the FERC's decision to the U.S. Court of Appeals for the Fourth Circuit. PPL cannot predict the outcome of this proceeding.

In December 2008, the PJM submitted amendments to certain provisions governing its RPM capacity market. The amendments were intended to permit the compensation available to suppliers that provide capacity, like PPL Energy Supply, to increase. The PJM sought approval of the amendments in time for them to be implemented for the May 2009 capacity auction (for service in June 2012 through May 2013). Numerous parties, including PPL, protested the PJM's filing. Certain of the protesting parties proposed changes to the capacity market auction that would result in a reduction in compensation to capacity suppliers. The changes proposed by the PJM and by other parties in response to the PJM proposals could significantly affect the compensation available to suppliers of capacity participating in future RPM auctions. In March 2009, the FERC entered an order approving in part and disapproving in part the changes proposed by the PJM. In August 2009, the FERC issued an order granting rehearing in part, denying rehearing in part and clarifying its March 2009 order. PPL cannot predict the outcome of this proceeding. No request for rehearing or appeal of the August 2009 order has been timely filed.

#### FERC Market-Based Rate Authority (PPL and PPL Energy Supply)

In December 1998, the FERC authorized PPL EnergyPlus to make wholesale sales of electric power and related products at market-based rates. In that order, the FERC directed PPL EnergyPlus to file an updated market analysis within three years after the order, and every three years thereafter. Since then, periodic market-based rate filings with the FERC have been made by PPL EnergyPlus, PPL Electric, PPL Montana and most of PPL Generation's subsidiaries. These filings consisted of a Western market-based rate filing for PPL Montana and an eastern market-based rate filing for most of the other PPL subsidiaries in the PJM region. The next filings will be due later in 2010.

Currently, a seller granted market-based rate authority by the FERC may enter into power contracts during an authorized time period. If the FERC determines that the market is not workably competitive or that the seller possesses market power or is not charging "just and reasonable" rates, it may institute prospective action, but any contracts entered into pursuant to the FERC's market-based rate authority remain in effect and are generally subject to a high standard of review before the FERC can order changes. Recent court decisions by the U.S. Court of Appeals for the Ninth Circuit have raised issues that may make it more difficult for the FERC to continue its program of promoting wholesale electricity competition through market-based rate authority. These court decisions permit retroactive refunds and a lower standard of review by the FERC for changing power contracts, and could have the effect of requiring the FERC in advance to review most, if not all, power contracts. In June 2008, the U.S. Supreme Court reversed one of the decisions of the U.S. Court of Appeals for the Ninth Circuit, thereby upholding the higher standard of review for modifying contracts. The FERC has not yet taken action in response to these recent court decisions. At this time, PPL cannot predict the impact of these court decisions on the FERC's future market-based rate authority program or on PPL's business.

#### IRS Synthetic Fuels Tax Credits (PPL and PPL Energy Supply)

PPL, through its subsidiaries, had interests in two synthetic fuel production facilities: the Somerset facility, located in Pennsylvania, and the Tyrone facility, located in Kentucky. PPL received tax credits pursuant to Section 29/45K of the Internal Revenue Code based on the sale of synthetic fuel from these facilities. The Section 29/45K tax credit program expired at the end of 2007, and production of synthetic fuel at these facilities and all other synthetic fuel operations ceased as of December 31, 2007. The facilities were dismantled and retired in 2008.

In April 2008, the IRS published the domestic first purchase price (DFPP) for 2007 indicating that the DFPP reference price increased above PPL's estimated price levels for 2007 and the inflation-adjusted phase-out range decreased from PPL's estimate for 2007. Therefore, PPL recorded an expense of \$13 million (\$.04 per share, basic and diluted, for PPL) in 2008, to "Income Taxes" on the Statement of Income to account for this difference.

#### Energy Policy Act of 2005 - Reliability Standards (PPL, PPL Energy Supply and PPL Electric)

In August 2005, the Energy Policy Act of 2005 (the 2005 Energy Act) became law. The 2005 Energy Act substantially affects the regulation of energy companies, amends federal energy laws and provides the FERC with new oversight responsibilities. Among the important changes this law is the appointment of the NERC to establish and enforce mandatory reliability standards (Reliability Standards) regarding the bulk power system. The FERC oversees this process and independently enforces the Reliability Standards.

The Reliability Standards have the force and effect of law and apply to certain users of the bulk power electricity system, including electric utility companies, generators and marketers. The FERC has indicated it intends to enforce vigorously the Reliability Standards using, among



other means, civil penalty authority. Under the Federal Power Act, the FERC may assess civil penalties of up to \$1 million per day, per violation, for certain violations. The first group of Reliability Standards approved by the FERC became effective in June 2007.

Since 2007, PPL Electric and certain subsidiaries of PPL Energy Supply have self-reported to the RFC potential violations of certain applicable reliability requirements and submitted accompanying mitigation plans, the resolutions of which potential violation reports are pending. Any FERC determination concerning the resolution of violations of the Reliability Standards remains subject to the approval of the NERC and the FERC. PPL Electric has reached agreement with the RFC concerning some, but not all, of the reliability matters reported by it to the RFC. PPL Electric and PPL Energy Supply cannot predict the outcome of these matters.

In the course of implementing its program to ensure compliance with the Reliability Standards by those PPL affiliates subject to the standards, certain other instances of potential non-compliance will continue to be identified from time to time. PPL cannot predict the fines or penalties that may be imposed.

#### U.K. Overhead Electricity Networks (PPL and PPL Energy Supply)

In 2002, for safety reasons, the U.K. Government issued guidance that low voltage overhead electricity networks within three meters horizontal clearance of a building should either be insulated or relocated. This imposed a retroactive requirement on existing assets that were built with lower clearances. In 2008, following extensive discussion, the U.K. Government determined that the U.K. electricity network should comply with the guidance issued. WPD estimates that the cost of compliance will be approximately \$93 million. The projected expenditures over the next five years have been allowed to be recovered through rates and it is expected that expenditures beyond this five year period will also be recovered through rates. The Government has determined that WPD (South Wales) should comply by 2015 and WPD (South West) by 2018.

In January 2009, to improve network reliability the U.K. Government enforced a regulation requiring network operators to implement a risk-based program over 25 years to clear trees within falling distance of key high-voltage overhead lines. WPD estimates that the cost of compliance will be approximately \$107 million over the 25-year period. The projected expenditures over the next five years have been allowed to be recovered through rates and it is expected that expenditures beyond this five year period will also be recovered through rates.

#### **Environmental Matters - Domestic**

##### *(PPL, PPL Energy Supply and PPL Electric)*

Due to the environmental issues discussed below or other environmental matters, PPL subsidiaries may be required to modify, curtail, replace or cease operating certain facilities or operations to comply with statutes, regulations and other requirements of regulatory bodies or courts. In this regard, PPL subsidiaries also may incur capital expenditures or operating expenses in amounts which are not now determinable, but could be significant.

##### Air (PPL and PPL Energy Supply)

The Clean Air Act addresses, among other things, emissions causing acid deposition, installation of best available control technologies for new or substantially modified sources, attainment of federal ambient air quality standards, toxic air emissions and visibility standards in the U.S. Amendments to the Clean Air Act requiring additional emission reductions are likely to continue to be proposed in the U.S. Congress. The Clean Air Act allows states to develop more stringent regulations and in some instances, as discussed below, Pennsylvania and Montana have done so.

##### *Clean Air Interstate Rule (CAIR)*

Citing its authority under the Clean Air Act, in 1997, the EPA developed new standards for ambient levels of ozone and fine particulates in the U.S. To facilitate attainment of these standards, the EPA promulgated CAIR for 28 midwestern and eastern states, including Pennsylvania, to reduce sulfur dioxide emissions by about 50% by 2010 and to extend the current seasonal program for reduction in nitrogen oxides emissions to a year-round program starting in 2009. Starting in 2015, CAIR requires further reductions in the CAIR region, in sulfur dioxide of 30% from 2010 levels, and nitrogen oxides during the ozone season of approximately 17% from 2009 levels. CAIR allows these reductions to be achieved through cap-and-trade programs.

In July 2008, the United States Court of Appeals for the D.C. Circuit (the U.S. Circuit Court) issued a ruling that invalidated CAIR in its entirety, including its cap-and-trade program.

As a result of this decision, in 2008, PPL determined that all of the annual nitrogen oxide allowances purchased by PPL EnergyPlus pursuant to CAIR were no longer required, had no value and, therefore, recorded a pre-tax impairment charge of \$33 million (\$20 million after tax). Further, PPL EnergyPlus recorded in the third quarter 2008 an additional charge and corresponding reserve of \$12 million pre-tax (\$7 million after tax) related to its sale of certain annual nitrogen oxide allowance put options. These charges, recorded in PPL and PPL Energy Supply's Supply segment, are included in "Other operation and maintenance" expense on the Statement of Income. The U.S. Circuit Court's decision did not impact PPL EnergyPlus' seasonal nitrogen oxide allowances.

In December 2008, the U.S. Circuit Court remanded CAIR to the EPA without vacating the cap-and-trade program, effectively reinstating, at least temporarily, CAIR and its requirements for annual-reduction of nitrogen oxides beginning in 2009 and for further reduction in sulfur dioxide by requiring the surrender of two acid rain allowances for every ton of sulfur dioxide emitted beginning in 2010. As a result of this December 2008 ruling and associated delivery of allowances under other option contracts that were not in dispute, the reserve recorded in the third quarter of 2008 of \$12 million pre-tax (\$7 million after-tax) related to certain annual nitrogen oxide allowance put options was revised in

the fourth quarter of 2008 to \$9 million pre-tax (\$5 million after tax).

See Note 17 for information on impairments recorded in 2009 related to sulfur dioxide emission allowances.

To continue meeting the sulfur dioxide reduction requirements under the acid rain provisions of the Clean Air Act, and the reductions required by CAIR (remanded by the U.S. Circuit Court, but currently in place), PPL installed and is operating scrubbers at its Montour and Brunner Island plants. In addition, with respect to compliance with annual and ozone season nitrogen oxide reduction requirements, PPL utilizes SCRs and combustion controls at Montour Units 1 and 2, and combustion controls at Brunner Island Units 1, 2 and 3. Additional emission allowances, when needed, are purchased in the open market.

The ultimate disposition of CAIR's cap-and-trade program and the value of annual nitrogen oxide allowances, as well as sulfur dioxide allowances, remain uncertain. If the EPA revises CAIR to require more stringent emission reductions or revises CAIR to eliminate or limit the regional cap-and-trade program, the costs of compliance are not now determinable, but could be significant.

Further reductions in sulfur dioxide and nitrogen oxide emissions, beyond those required by CAIR, could be required as a result of more stringent national ambient air quality standards for ozone, nitrogen dioxide, sulfur dioxide and fine particulates. If additional reductions were to be required, the costs are not now determinable, but could be significant.

#### *Mercury and other Hazardous Air Pollutants*

Citing its authority under the Clean Air Act, in May 2005, the EPA issued the Clean Air Act Mercury Regulations (CAMR) affecting coal-fired power plants. These regulations establish a cap-and-trade program to take effect in two phases, with the first phase to begin in January 2010, and the second, more stringent, phase to begin in January 2018. Because of a February 2008 decision by the U.S. Circuit Court of Appeals overturning CAMR, the EPA is proceeding to develop standards imposing MACT for mercury emissions and other hazardous air pollutants from electric generating units. Under a recent proposed settlement, the EPA is planning to issue final MACT standards by November 2011. In order to develop these standards, the EPA is collecting information from coal-and-oil-fired electric utility steam generating units. The costs of complying with the final MACT standards are not now determinable, but could be significant.

Pennsylvania adopted mercury emission standards more stringent than CAMR. However, PPL challenged those rules under the provisions of the Pennsylvania Air Pollution Control Act in light of the federal court decision overturning CAMR, and in December 2009, the Pennsylvania Supreme Court declared the Pennsylvania mercury rules invalid and unenforceable.

In 2006, Montana finalized its mercury emission rules that require, by 2010, every coal-fired generating plant in Montana to achieve reductions more stringent than CAMR's 2018 requirements. PPL has installed chemical injection systems to meet these requirements.

#### *Regional Haze and Visibility*

The Clean Air Visibility Rule was issued by the EPA in June 2005, to address regional haze or regionally-impaired visibility caused by multiple sources over a wide area. The rule requires Best Available Retrofit Technology (BART) for certain electric generating units. Under the BART rule, PPL submitted to the Pennsylvania DEP its analyses of the visibility impacts of particulate matter emissions from Martins Creek Units 3 and 4, Brunner Island Units 2 and 3 and Montour Units 1 and 2. No analysis was submitted for sulfur dioxide or nitrogen oxides because the EPA determined that meeting the requirements for CAIR also meets the BART requirements for those pollutants. PPL's analyses have shown that because PPL had already upgraded its particulate emissions controls at Montour Units 1 and 2 and Brunner Island Units 2 and 3 further controls are not justified as there would be little corresponding visibility improvement. PPL has not received comments from the Pennsylvania DEP on these submissions.

Also under the BART rule, PPL submitted to the EPA its analyses of the visibility impacts of sulfur dioxide, nitrogen oxides and particulate matter emissions for Colstrip Units 1 and 2 and Corette. PPL's analyses concluded that further reductions are not needed. The EPA responded to PPL's reports for Colstrip and Corette and requested further information and analysis. PPL completed further analysis and submitted addendums to its initial reports for Colstrip and Corette. In February 2009, PPL received an information request for additional data related to the Colstrip generating station non-BART affected emission sources. PPL responded to this request in March 2009. PPL has not received comments from the EPA on these submissions.

PPL cannot predict whether any additional reductions will be required in Pennsylvania or Montana. If additional reductions are required, the costs are not now determinable, but could be significant.

#### *New Source Review (NSR)*

The EPA has reinitiated its NSR enforcement efforts. This initiative targets older, coal-fired power plants. The EPA has asserted that modification to these plants has increased their emissions and consequently they are subject to more stringent NSR requirements under the Clean Air Act. In April 2009, PPL received EPA information requests for its Montour and Brunner Island plants. PPL has met with the EPA and exchanged information regarding this matter. The requests are similar to those that PPL received several years ago for its Colstrip, Corette and Martins Creek plants. PPL's response to the request for Montour and Brunner Island is currently on hold pending further discussions with the EPA. PPL cannot predict the outcome of this matter.

In January 2009, PPL and other companies that own or operate the Keystone plant received a notice of violation from the EPA alleging that certain projects were undertaken without proper NSR compliance. PPL cannot predict the outcome of this matter.

States and environmental groups also have initiated enforcement actions and litigation alleging violations of the NSR regulations by coal-fired plants, and PPL is unable to predict whether such actions will be brought against any of PPL's plants.

If PPL is found to have violated NSR regulations, PPL would, among other things, be required to install best available control technology for any pollutant found to have significantly increased due to a major plant modification. The costs to install and operate such technology are not now determinable, but could be significant.

Pursuant to the 2007 U.S. Supreme Court decision on global climate change, as discussed below, the EPA is expected to regulate carbon dioxide emissions in 2010. Such regulation would subject carbon dioxide emissions to NSR regulations. As a result, in October 2009, the EPA published its proposal to require large industrial facilities that annually emit at least 25,000 tons of greenhouse gases, including carbon dioxide, to obtain construction and operating permits covering significant increases in these emissions if the facility undergoes any major modification or during initial construction. If the modifications result in emissions increases exceeding certain thresholds, which the EPA has not yet established, the plant will need to conduct an analysis of, and possibly implement, best available control technology for carbon dioxide emissions. To date, the EPA has not provided official guidance, but has indicated that it may look at efficiency projects as possible Best Available Control Technology for carbon dioxide emissions. The implications of these developments are uncertain and any associated costs are not now determinable, but could be significant.

### *Opacity*

From time to time environmental concerns are raised with respect to visible opacity of emissions from our power plants. PPL addresses these issues on a case by case basis. If it is determined that actions must be taken to address visible opacity issues, such actions could result in costs that are not now determinable, but could be significant.

### *Global Climate Change*

There is concern nationally and internationally about global climate change and the possible contribution of greenhouse gas emissions including, most significantly, carbon dioxide from the combustion of fossil fuels. This has resulted in increased demands for carbon dioxide emission reductions by investors, environmental organizations, government agencies and the international community. These demands and concerns have led to increased federal legislative proposals, actions at regional, state and local levels, as well as litigation relating to greenhouse gas emissions. Of particular note, in April 2007, the U.S. Supreme Court held that the EPA has the authority to regulate greenhouse gas emissions from new motor vehicles under the Clean Air Act. More recently, in September 2009, the U.S. Court of Appeals for the Second Circuit reversed a federal district court's decision and ruled that several states and public interest groups, as well as the City of New York, could sue five electric utility companies under federal common law for allegedly causing a public nuisance as a result of their emissions of greenhouse gases. Additional litigation in federal and state courts over these issues is continuing.

As a result of the 2007 Supreme Court's decision, in 2008, the EPA issued an "Advance Notice of Proposed Rulemaking," proposing alternative approaches to regulate carbon dioxide emissions. The EPA is moving forward with regulation of greenhouse gas emissions under the Clean Air Act. In 2009, the EPA also issued a rule, effective January 1, 2010, requiring economy-wide reporting of greenhouse gas emissions and in December 2009, issued a final endangerment finding that greenhouse gases contribute to air pollution and may endanger public health or welfare. The EPA's proposed light-duty vehicle emissions standards are expected to be finalized by March 31, 2010, leading to regulation of greenhouse gas emissions under the New Source Review provisions of the Clean Air Act. Accordingly, unless Congress acts sooner, it appears likely that greenhouse gas emissions will be regulated by the EPA.

In June 2009, the U.S. House of Representatives passed H.R. 2454, the American Clean Energy and Security Act of 2009. A key element affecting PPL includes a declining cap on carbon emissions beginning in 2012, which requires a three percent reduction in greenhouse gas emissions (below 2005 levels) by 2012, increasing to 83% by 2050. The legislation also would require that electric utilities meet a mandatory 20% renewable energy supply and energy efficiency requirement by 2020. In September 2009, S. 1733, the Clean Energy, Jobs and American Power Act, a comprehensive climate change bill, was introduced in the U.S. Senate. The Senate Committee on Environment and Public Works approved S.1733 in November 2009. Debate on climate legislation continues in Congress; however, given other competing legislative priorities, the timing and elements of any future legislation addressing greenhouse gas emission reductions and renewable energy requirements are uncertain.

Renewable electricity standards are currently included in a separate Senate bill, S.1462, the American Clean Energy Leadership Act of 2009, which passed in the Senate Energy Committee in June 2009. Under this bill, electric utilities would be required by 2021 to meet a 15% standard through renewable sources of energy and energy efficiency.

At the regional level, ten northeastern states signed a Memorandum of Understanding (MOU) agreeing to establish a greenhouse gas emission cap-and-trade program, called the Regional Greenhouse Gas Initiative (RGGI). The program commenced in January 2009 and calls for stabilization of carbon dioxide emissions, at base levels established in 2005, from electric power plants with capacity greater than 25 MW. The MOU also provides for a 10% reduction in carbon dioxide emissions from base levels by 2019.

Pennsylvania has not stated an intention to join RGGI, but has enacted the Pennsylvania Climate Change Act of 2008 (PCCA). The PCCA established a Climate Change Advisory Committee to advise the DEP on the development of a Climate Change Action Plan. In December 2009, the Advisory Committee finalized its Climate Change Action Report which identifies specific actions that could result in reducing greenhouse gas emissions by 30% by 2020. Some of the proposed actions, such as a mandatory 5% efficiency improvement at power plants, could be technically unachievable. In addition, legislation has been introduced in the Pennsylvania House of Representatives that would, if enacted, significantly increase renewable and solar supply requirements.

In the Western U.S., 11 states, including Montana, and Canadian provinces are members of the Western Climate Initiative (WCI). The WCI has established a goal of reducing carbon dioxide emissions 15% below 2005 levels by 2020 and is currently developing greenhouse gas emission allocations, offsets, and reporting recommendations.

PPL has conducted an inventory of its carbon dioxide emissions and is continuing to evaluate options for reducing, avoiding, off-setting or sequestering its carbon dioxide emissions. In 2009, PPL's power plants emitted in excess of approximately 25 million tons of carbon dioxide (based on PPL's equity share of these assets).

PPL understands there are financial, regulatory and logistical uncertainties related to greenhouse gas reductions and the implementation of renewable energy mandates. These will need to be resolved before the impact of such requirements on PPL can be meaningfully estimated. Such uncertainties, among others, include the need to provide back-up supply to augment intermittent renewable generation, potential generation oversupply that could result from such renewable generation and back-up, impacts to the PJM capacity market and the need for substantial changes to transmission and distribution systems to accommodate renewable energy; which uncertainties are not directly addressed by the proposed legislation. PPL cannot predict at this time the effect on its future competitive position, results of operation, cash flows and financial position, of any greenhouse gas emission, renewable energy mandate or other global climate change requirements that may be adopted, although the costs to implement and comply with any such requirements could be significant.

#### Water/Waste (PPL and PPL Energy Supply)

##### *Martins Creek Fly Ash Release*

In 2005, there was a release of approximately 100 million gallons of water containing fly ash from a disposal basin at the Martins Creek plant used in connection with the operation of the two 150 MW coal-fired generating units at the plant. This resulted in ash being deposited onto adjacent roadways and fields, and into a nearby creek and the Delaware River. The leak was stopped, and PPL determined that the release was caused by a failure in the disposal basin's discharge structure. PPL conducted extensive clean-up and completed studies, in conjunction with a group of natural resource trustees and the Delaware River Basin Commission, evaluating the effects of the release on the river's sediment, water quality and ecosystem.

The Pennsylvania DEP filed a complaint in Pennsylvania Commonwealth Court against PPL Martins Creek and PPL Generation, alleging violations of various state laws and regulations and seeking penalties and injunctive relief. PPL and the Pennsylvania DEP have settled this matter. The settlement required a payment of \$1.5 million in penalties and reimbursement of the DEP's costs. PPL made this payment in the second quarter of 2008. The settlement also requires PPL to submit a report on the completed studies of possible natural resource damages. PPL submitted the assessment report to the Pennsylvania and New Jersey regulatory agencies in 2007 and has continued discussing potential natural resource damages with the agencies.

Through December 31, 2009, PPL Energy Supply has spent \$28 million for remediation and related costs and an immaterial remediation liability remained. PPL and PPL Energy Supply cannot be certain of the outcome of the natural resource damage assessment or the associated costs, the outcome of any lawsuit that may be brought by citizens or businesses or the exact nature of any other regulatory or other legal actions that may be initiated against PPL, PPL Energy Supply or their subsidiaries as a result of the disposal basin release.

##### *Basin Seepage - Pennsylvania*

Seepages have been detected at active and retired wastewater basins at various PPL plants, including the Montour and Brunner Island generating facilities. PPL has completed an assessment of some of the seepages at the Montour and Brunner Island facilities and is working with the Pennsylvania DEP to implement abatement measures for those seepages. PPL continues to assess other seepages at the Brunner Island facility. PPL currently plans to spend up to \$64 million to upgrade and/or replace certain wastewater facilities in response to the seepages and for other facility changes. The potential additional cost to address the identified seepages or other seepages at all of PPL's Pennsylvania plants is not now determinable, but could be significant.

##### *Basin Seepage - Montana*

In May 2003, approximately 50 plaintiffs brought an action against PPL Montana and the other owners of the Colstrip plant alleging property damage from seepage from the freshwater and wastewater ponds at Colstrip. In July 2008, the plaintiffs and the owner-defendants remaining after dismissal of NorthWestern, due to its bankruptcy, executed a settlement agreement. PPL Montana's share of the settlement was approximately \$8 million. In 2008, PPL Montana recorded an insignificant reserve for its share of potential additional settlements with three property owners living near the original plaintiffs but who were not parties to the lawsuit. In the fourth quarter of 2009, PPL Montana settled with two of these property owners. PPL Montana may incur additional costs related to the potential claims, including additional groundwater investigations and any related remedial measures, which are not now determinable, but could be significant.

In 2007, six plaintiffs filed a separate lawsuit in the Montana Sixteenth Judicial District Court against the Colstrip plant owners asserting similar property damage claims as were asserted by the plaintiffs in the May 2003 complaint. The lawsuit is in its initial stages of discovery and investigation, and PPL Montana is unable to predict the outcome of these proceedings. PPL Montana has undertaken certain groundwater investigations and remediation at the Colstrip plant to address groundwater contamination alleged by the plaintiffs, as well as other groundwater contamination at the plant. PPL Montana may incur further costs based on the outcome of this lawsuit and its additional groundwater investigations and any related remedial measures, which are not now determinable, but could be significant.

##### *Other Issues*

In 2006, the EPA significantly decreased to 10 parts per billion (ppb), the drinking water standard related to arsenic. In Pennsylvania and Montana, this arsenic standard has been incorporated into the states' water quality standards and could result in more stringent limits to PPL's NPDES permits for its Pennsylvania and Montana plants. Recently, the EPA developed a draft risk assessment of arsenic that increases the cancer risk exposure by more than 20 times, which would lower the current standard from 10 ppb to 0.1 ppb. If the lower standard became effective, very expensive treatment would be required to attempt to meet the standard and, at this time, there is no assurance that it could be achieved.

The EPA finalized requirements in 2004 for new or modified cooling water intake structures. These requirements affect where generating facilities are built, establish intake design standards and could lead to requirements for cooling towers at new and modified power plants. Another rule, finalized in 2004, that addressed existing structures was withdrawn following a 2007 decision by the U.S. Court of Appeals for the Second Circuit. In 2008, however, the U.S. Supreme Court ruled that the EPA has discretion to use cost-benefit analysis in determining the best technology available for minimizing adverse environmental impact. The EPA is developing a new rule which is expected to be finalized in 2012. How the cost-benefit analysis will be employed, if incorporated, as well as other issues raised by the Second Circuit Court (not reviewed by the U.S. Supreme Court) and actions the states may take on their own could result in stricter standards for existing structures that could impose significant costs on PPL subsidiaries.

In October 2009, the EPA released its Final Detailed Study of the Steam Electric Power Generating effluent limitations guidelines and standards. Draft regulations that would include revisions to the effluent limitations guidelines are expected to be published in September 2011, with final regulations to be effective September 2013. PPL expects the revised guidelines and standards to be more stringent than the current standards, which could result in more stringent discharge permit limits.

PPL has signed a consent order with the Pennsylvania DEP under which it will take further actions to minimize the possibility of fish kills at its Brunner Island plant. Fish are attracted to warm water in power plant discharge channels, especially during cold weather. In the past, fish kills have occurred at Brunner Island when debris at intake pumps resulted in a unit trip or reduction in load, causing a sudden change in water temperature in the discharge channel when fish were present. In 2008, PPL paid a nominal penalty to the DEP for fish kills at Brunner Island that occurred in 2008 and 2007.

PPL has committed to construct a barrier to prevent debris from entering the intake area. PPL expects to construct the debris barrier in 2010 at a cost of approximately \$4 million. PPL has also committed to investigate alternatives to exclude fish from the discharge area. PPL will need to implement one of these fish exclusion alternatives if a fish kill occurs after the cooling towers become operational at Brunner Island in 2010.

The EPA is considering establishing regulations under the Resource Conservation and Recovery Act (RCRA) that could impact the disposal and management of coal combustion products (CCPs), including ash and scrubber wastes and other by-products. Following the large ash release at a Tennessee Valley Authority site in Tennessee in December 2008 and subsequent widespread media coverage, the EPA, under pressure from certain environmental groups and legislators, has committed to proposing CCP regulations. Draft regulations are expected in 2010. The EPA has been seeking information from the power industry as it considers whether or not to regulate CCPs as hazardous waste, and PPL has responded to the EPA's requests. The EPA conducted a follow-up inspection of PPL Montana's Colstrip plant and PPL's Martins Creek plant. PPL is implementing certain actions in response to recommendations from these inspections. In June 2009, the EPA's Office of Enforcement and Compliance Assurance issued a much broader information request to Colstrip and 18 other non-affiliated plants, seeking information under the RCRA, the Clean Water Act and the Emergency Planning and Community Right-to-Know Act. PPL responded to the EPA's broader information request. Although the EPA's enforcement office issued the request, the EPA has not necessarily concluded that the plants are in violation of any EPA requirements. The EPA conducted a multi-media inspection at Colstrip in August 2009 and has not yet issued a report from that inspection. PPL cannot predict at this time the outcome of these matters or the requirements of the EPA's regulations and what impact, if any, they would have on PPL's facilities, but the costs to PPL could be significant.

#### Superfund and Other Remediation

*(PPL, PPL Energy Supply and PPL Electric)*

PPL Electric is a potentially responsible party at several sites listed by the EPA under the federal Superfund program, including the Columbia Gas Plant Site, the Metal Bank site and the Ward Transformer site. Clean-up actions have been or are being undertaken at all of these sites, the costs of which have not been significant to PPL. However, should the EPA require different or additional measures in the future, or should PPL's share of costs at multi-party sites increase significantly more than currently expected, the costs to PPL could be significant.

PPL Electric has been remediating several sites that were not being addressed under another regulatory program such as Superfund, but for which PPL Electric may be liable for remediation. These include a number of coal gas manufacturing facilities formerly owned or operated by a predecessor to PPL Electric.

Depending on the outcome of investigations at sites where investigations have not begun or have not been completed, the costs of remediation and other liabilities could be substantial. PPL and its subsidiaries also could incur other non-remediation costs at sites included in the consent orders or other contaminated sites, the costs of which are not now determinable, but could be significant.

The EPA is evaluating the risks associated with naphthalene, a chemical by-product of coal gas manufacturing. As a result of the EPA's evaluation, individual states may establish stricter standards for water quality and soil cleanup. This could require several PPL subsidiaries to take more extensive assessment and remedial actions at former coal gas manufacturing facilities. The costs to PPL of complying with any such requirements are not now determinable, but could be significant.

*(PPL and PPL Energy Supply)*

Under the Pennsylvania Clean Streams Law, subsidiaries of PPL Generation are obligated to remediate acid mine drainage at former mine sites and may be required to take additional steps to prevent potential acid mine drainage at previously capped refuse piles. One PPL Generation subsidiary is pumping mine water at two mine sites and treating water at one of these sites. Another PPL Generation subsidiary has installed a passive wetlands treatment system at a third site. At December 31, 2009, PPL Energy Supply had accrued a discounted liability of \$24 million to cover the costs of pumping and treating groundwater at the two mine sites for 50 years and for operating and maintaining passive wetlands treatment at the third site. PPL Energy Supply discounted this liability based on risk-free rates at the time of the mine closures. The weighted average rate used was 8.04%. Expected undiscounted payments are estimated at \$1 million for each of the years from 2010 through 2014, and \$144 million for work after 2014.

*(PPL, PPL Energy Supply and PPL Electric)*

Future cleanup or remediation work at sites currently under review, or at sites not currently identified, may result in material additional operating costs for PPL subsidiaries that cannot be estimated at this time.

*Electric and Magnetic Fields (PPL, PPL Energy Supply and PPL Electric)*

Concerns have been expressed by some members of the public regarding potential health effects of power frequency EMFs, which are emitted by all devices carrying electricity, including electric transmission and distribution lines and substation equipment. Government officials in the U.S. and the U.K. have reviewed this issue. The U.S. National Institute of Environmental Health Sciences concluded in 2002 that, for most health outcomes, there is no evidence that EMFs cause adverse effects. The agency further noted that there is some epidemiological evidence of an association with childhood leukemia, but that the evidence is difficult to interpret without supporting laboratory evidence. The U.K. National Radiological Protection Board (part of the U.K. Health Protection Agency) concluded in 2004 that, while the research on EMFs does not provide a basis to find that EMFs cause any illness, there is a basis to consider precautionary measures beyond existing exposure guidelines. In April 2007, the Stakeholder Group on Extremely Low Frequency EMF, set up by the U.K. Government, issued its interim assessment which describes a number of options for reducing public exposure to EMFs. The U.K. Government responded to this assessment in October 2009, agreeing to some of the proposals, including a proposed voluntary code to optimally phase 132 kilovolt overhead lines to reduce public exposure to EMF where it is cost effective to do so. PPL and its subsidiaries believe the current efforts to determine whether EMFs cause adverse health effects should continue and are taking steps to reduce EMFs, where practical, in the design of new transmission and distribution facilities. PPL and its subsidiaries are unable to predict what effect, if any, the EMF issue might have on their operations and facilities either in the U.S. or the U.K., and the associated cost, or what, if any, liabilities they might incur related to the EMF issue.

**Environmental Matters - WPD** *(PPL and PPL Energy Supply)*

WPD's distribution businesses are subject to environmental regulatory and statutory requirements. PPL believes that WPD has taken and continues to take measures to comply with the applicable laws and governmental regulations for the protection of the environment.

The U.K. government has implemented a project to determine the impact of flooding on the U.K. utility infrastructure, including major electricity substations. WPD has agreed with the Ofgem to spend \$28 million on flood prevention, which will be recovered through rates during the 5-year period commencing April 2010.

U.K. legislation has been passed that imposes a duty on certain companies including WPD to report on climate change adaptation. It is expected that the first "Direction to Report" will be issued early in 2010 with reports due for submission at the end of the year.

There are no other material legal or administrative proceedings pending against or related to WPD with respect to environmental matters. See "Environmental Matters - Domestic - Superfund and Other Remediation - Electric and Magnetic Fields" for a discussion of EMFs.

## **Other**

Labor Unions *(PPL, PPL Energy Supply and PPL Electric)*

At December 31, 2009, the breakdown of the total workforce that is represented by unions was:

	<u>Number of Employees</u>	<u>Percent of Total Workforce</u>
PPL	6,840	65%
PPL Energy Supply	4,850	69%
PPL Electric	1,570	72%

In May 2010, PPL's bargaining agreement with its largest IBEW local expires. The agreement covers the following:

	<u>Number of Employees</u>	<u>Percent of Total Workforce</u>
PPL	3,200	31%
PPL Energy Supply	1,210	17%
PPL Electric	1,570	72%

Negotiations commenced in February 2010. PPL cannot predict the outcome of the collective labor bargaining negotiations.  
Nuclear Insurance (PPL and PPL Energy Supply)

PPL Susquehanna is a member of certain insurance programs that provide coverage for property damage to members' nuclear generating stations. Facilities at the Susquehanna station are insured against property damage losses up to \$2.75 billion under these programs. PPL Susquehanna is also a member of an insurance program that provides insurance coverage for the cost of replacement power during prolonged outages of nuclear units caused by certain specified conditions. Under the property and replacement power insurance programs, PPL Susquehanna could be assessed retroactive premiums in the event of the insurers' adverse loss experience. At December 31, 2009, this maximum assessment was \$37 million.

In the event of a nuclear incident at the Susquehanna station, PPL Susquehanna's public liability for claims resulting from such incident would be limited to \$12.6 billion under provisions of The Price-Anderson Act Amendments under the Energy Policy Act of 2005. PPL Susquehanna is protected against this liability by a combination of commercial insurance and an industry assessment program. In the event of a nuclear incident at any of the reactors covered by The Price-Anderson Act Amendments under the Energy Policy Act of 2005, PPL Susquehanna could be assessed up to \$235 million per incident, payable at \$35 million per year.

At December 31, 2009, the property, replacement power and nuclear incident insurers maintained an A.M. Best financial strength rating of A ("Excellent").

Guarantees and Other Assurances

(PPL, PPL Energy Supply and PPL Electric)

In the normal course of business, PPL, PPL Energy Supply and PPL Electric enter into agreements that provide financial performance assurance to third parties on behalf of certain subsidiaries. Such agreements include, for example, guarantees, stand-by letters of credit issued by financial institutions and surety bonds issued by insurance companies. These agreements are entered into primarily to support or enhance the creditworthiness attributed to a subsidiary on a stand-alone basis or to facilitate the commercial activities in which these subsidiaries enter.

(PPL)

PPL fully and unconditionally guarantees all of the debt securities of PPL Capital Funding.

(PPL, PPL Energy Supply and PPL Electric)

The table below details guarantees provided as of December 31, 2009. The total recorded liability at December 31, 2009 and 2008 was \$3 million and \$4 million. Other than as noted in the description for "WPD guarantee of pension and other obligations of unconsolidated entities," the probability of expected payment/performance under each of these guarantees is remote.

	<b>Exposure at December 31, 2009 (a)</b>	<b>Expiration Date</b>	<b>Description</b>
<b>PPL</b>			
Indemnifications for sale of PPL Gas Utilities	\$ 300		PPL has provided indemnification to the purchaser of PPL Gas Utilities and Penn Fuel Propane, LLC for damages arising out of any breach of the representations, warranties and covenants under the related transaction agreement and for damages arising out of certain other matters, including certain pre-closing unknown environmental liabilities relating to former manufactured gas plant properties or off-site disposal sites, if any, outside of Pennsylvania. The indemnification provisions for most representations and warranties, including tax and environmental matters, are capped at 15% of the purchase price (\$45 million), in the aggregate, and are triggered (i) only if the individual claim exceeds \$50,000, and (ii) only if, and only to the extent that, in the aggregate, total claims exceed 1.5% of the purchase price (\$4.5 million). The indemnification provisions for most representations and warranties expired on September 30, 2009 without any claims having been made. Certain representations and warranties, including those having to do with transaction authorization and title, survive indefinitely, are capped at the purchase price and are not subject to the above threshold or deductible. The indemnification provision for the tax matters representations survives for the duration of the applicable statute of limitations, and the indemnification provision for the environmental matters representations survives for a period of three years after the transaction closing. The indemnification relating to unknown environmental liabilities for manufactured gas plants and disposal sites outside of Pennsylvania could survive more than three years, but only with respect to applicable property or sites identified by

the purchaser prior to the third anniversary of the transaction closing. The indemnification for covenants survives until the applicable covenant is performed and is not subject to any cap.

**PPL Energy Supply (b)**

Letters of credit issued on behalf of affiliates	17	2010 to 2011	Standby letter of credit arrangements under PPL Energy Supply's credit facilities for the purposes of protecting various third parties against nonperformance by PPL. This is not a guarantee by PPL on a consolidated basis.
Retroactive premiums under nuclear insurance programs	37		PPL Susquehanna is contingently obligated to pay this amount related to potential retroactive premiums that could be assessed under its nuclear insurance programs. See "Nuclear Insurance" for additional information.
Nuclear claims under The Price-Anderson Act Amendments under The Energy Policy Act of 2005	235		This is the maximum amount PPL Susquehanna could be assessed for each incident at any of the nuclear reactors covered by this Act. See "Nuclear Insurance" for additional information.
Indemnifications for entities in liquidation and sales of assets	186	2010 to 2012	<p>PPL Energy Supply's maximum exposure with respect to certain indemnifications and the expiration of the indemnifications cannot be estimated because, in the case of certain indemnification provisions, the maximum potential liability is not capped by the transaction documents and the expiration date is based on the applicable statute of limitations. The exposure and expiration dates noted are only for those cases in which the agreements provide for specific limits.</p> <p>In connection with the liquidation of wholly owned subsidiaries that have been deconsolidated upon turning the entities over to the liquidators, certain affiliates of PPL Global have agreed to indemnify the liquidators, directors and/or the entities themselves for any liabilities or expenses arising during the liquidation process, including liabilities and expenses of the entities placed into liquidation. In some cases, the indemnifications are limited to a maximum amount that is based on distributions made from the subsidiary to its parent either prior or subsequent to being placed into liquidation. In other cases, the maximum amount of the indemnifications is not explicitly stated in the agreements. The indemnifications generally expire two to seven years subsequent to the date of dissolution of the entities. The exposure noted only includes those cases in which the agreements provide for a specific limit on the amount of the indemnification, and the expiration date was based on an estimate of the dissolution date of the entities. In 2009, \$212 million of previously disclosed exposure expired.</p> <p>In connection with their sales of various businesses, WPD and its affiliates have provided the purchasers with indemnifications that are standard for such transactions, including indemnifications for certain pre-existing liabilities and environmental and tax matters. In addition, in connection with certain of these sales, WPD and its affiliates have agreed to continue their obligations under existing third-party guarantees, either for a set period of time following the transactions or upon the condition that the purchasers make reasonable efforts to terminate the guarantees. Finally, WPD and its affiliates remain secondarily responsible for lease payments under certain leases that they have assigned to third parties.</p> <p>A subsidiary of PPL Energy Supply has agreed to provide indemnification to the purchaser of the six Maine hydroelectric facilities for damages arising out of any breach of the representations, warranties and covenants under the related transaction agreement and for damages arising out of certain other matters, including liabilities of the PPL Energy Supply subsidiary relating to the pre-closing ownership or operation of those hydroelectric facilities or relating to other assets of the PPL Energy Supply subsidiary that were not included in that sale. The indemnification obligations are subject to certain customary limitations, including thresholds for allowable claims, caps on aggregate liability, and time limitations for claims arising out of</p>



breaches of representations and warranties.

PPL Energy Supply has provided indemnification to the purchaser of a generating facility for losses arising out of any breach of the representations, warranties and covenants under the related transaction documents and for losses arising with respect to liabilities not specifically assumed by the purchaser, including certain pre-closing environmental and tort liabilities. The indemnification other than for pre-closing environmental and tort liabilities is triggered only if the purchaser's losses reach \$1 million in the aggregate, capped at 50% of the purchase price (or \$95 million), and either expired in May 2007 or will expire pursuant to applicable statutes of limitations. The indemnification provision for unknown environmental and tort liabilities related to periods prior to PPL Energy Supply's ownership of the real property on which the facility is located is capped at \$4 million in the aggregate and survives for a maximum period of five years after the transaction closing.

Indemnification to operators of jointly owned facilities	6		In December 2007, a subsidiary of PPL Energy Supply executed revised owners agreements for two jointly owned facilities, the Keystone and Conemaugh generating stations. The agreements require that in the event of any default by an owner, the other owners fund contributions for the operation of the generating stations, based upon their ownership percentages. The maximum obligation among all owners, for each station, is currently \$20 million. The non-defaulting owners, who make up the defaulting owner's obligations, are entitled to the generation entitlement of the defaulting owner, based upon their ownership percentage. The agreements do not have an expiration date.
WPD guarantee of pension and other obligations of unconsolidated entities	31	2017	As a result of the privatization of the utility industry in the U.K., certain electric associations' roles and responsibilities were discontinued or modified. As a result, certain obligations, primarily pension-related, associated with these organizations have been guaranteed by the participating members. Costs are allocated to the members based on predetermined percentages as outlined in specific agreements. However, if a member becomes insolvent, costs can be reallocated to and are guaranteed by the remaining members. At December 31, 2009, WPD has recorded an estimated discounted liability based on its current allocated percentage of the total expected costs for which the expected payment/performance is probable. Neither the expiration date nor the maximum amount of potential payments for certain obligations is explicitly stated in the related agreements. Therefore, they have been estimated based on the types of obligations.
Tax indemnification related to unconsolidated WPD affiliates	8	2012	Two WPD unconsolidated affiliates were refinanced during 2005. Under the terms of the refinancing, WPD has indemnified the lender against certain tax and other liabilities.
Guarantee of a portion of an unconsolidated entity's debt	22	2018	Reflects principal payments only.

- (a) Represents the estimated maximum potential amount of future payments that could be required to be made under the guarantee.
- (b) Other than the letters of credit, all guarantees of PPL Energy Supply, on a consolidated basis, also apply to PPL on a consolidated basis. Neither PPL nor PPL Energy Supply is liable for obligations under guarantees provided by WPD, as the beneficiaries of the guarantees do not have recourse to such entities.

PPL, PPL Energy Supply and PPL Electric and their subsidiaries provide other miscellaneous guarantees through contracts entered into in the normal course of business. These guarantees are primarily in the form of indemnification or warranties related to services or equipment and vary in duration. The amounts of these guarantees often are not explicitly stated, and the overall maximum amount of the obligation under such guarantees cannot be reasonably estimated. Historically, PPL, PPL Energy Supply and PPL Electric and their subsidiaries have not made any significant payments with respect to these types of guarantees and the probability of payment/performance under these guarantees is remote.

PPL, on behalf of itself and certain of its subsidiaries, maintains insurance that covers liability assumed under contract for bodily injury and property damage. The coverage requires a \$4 million deductible per occurrence and provides maximum aggregate coverage of \$150 million. This insurance may be applicable to obligations under certain of these contractual arrangements.

## 15. Related Party Transactions

### Affiliate Trust (PPL and PPL Energy Supply)

In February 2007, WPD LLP redeemed all of the 8.23% Subordinated Debentures maturing in February 2027 that were held by SIUK Capital Trust I. Upon redemption, WPD LLP paid a premium of 4.115%, or approximately \$3 million, on the principal amount of \$85 million of subordinated debentures. Payment of \$29 million was also made to settle related cross-currency swaps and is included on the Statement of Cash Flows as a component of "Retirement of long-term debt." Interest expense on this obligation was \$2 million for 2007. The redemption resulted in a recorded loss of \$2 million during 2007. This interest expense and loss are both reflected in "Interest Expense" for PPL and PPL Energy Supply on the Statement of Income.

### PLR Contracts (PPL Energy Supply and PPL Electric)

PPL Electric had power purchase agreements with PPL EnergyPlus, effective July 2000 and January 2002, under which PPL EnergyPlus supplied PPL Electric's entire PLR load. These contracts expired December 31, 2009. Under these contracts, PPL EnergyPlus provided electricity at the predetermined capped prices that PPL Electric was authorized to charge its PLR customers. These purchases totaled \$1.8 billion in 2009, 2008 and 2007. These purchases include nuclear decommissioning recovery and amortization of an up-front contract payment and are included in the Statements of Income as "Wholesale energy marketing to affiliate" by PPL Energy Supply, and as "Energy purchases from affiliate" by PPL Electric.

Under one of the PLR contracts, PPL Electric was required to make performance assurance deposits with PPL EnergyPlus when the market price of electricity was less than the contract price by more than its contract collateral threshold. Conversely, PPL EnergyPlus was required to make performance assurance deposits with PPL Electric when the market price of electricity was greater than the contract price by more than its contract collateral threshold. At December 31, 2008, PPL Energy Supply was required to provide PPL Electric with performance assurance of \$300 million. PPL Electric paid interest equal to the one-month LIBOR plus 0.5% on this deposit, which is included in "Interest Expense with Affiliate" on the Statements of Income. PPL Energy Supply recorded the receipt of the interest as affiliated interest income, which is included in "Interest Income from Affiliates" on the Statements of Income. Interest related to the required deposits was \$2 million, \$10 million and \$17 million for 2009, 2008 and 2007.

PPL Electric has held competitive solicitations for generation supply in 2010 and 2011. PPL EnergyPlus was one of the successful bidders in the first competitive solicitation process and has entered into an agreement with PPL Electric to supply up to 671 MW of total peak load in 2010, at an average price of \$91.42 per MWh.

Under the standard Supply Master Agreement for the bid solicitation process, PPL Electric requires all suppliers to post collateral once credit exposures exceed defined credit limits. In no instance is PPL Electric required to post collateral to suppliers under these supply contracts. With respect with its agreement with PPL Electric, PPL EnergyPlus is required to post collateral with PPL Electric: (a) when the market price of electricity to be delivered by PPL EnergyPlus exceeds the contract price for the forecasted quantity of electricity to be delivered and (b) this market price exposure exceeds a contractual credit limit. Based on the current credit rating of PPL Energy Supply, as guarantor, this credit limit is \$35 million.

PPL Energy Supply has credit exposure to PPL Electric under certain energy supply contracts. See Note 17 for additional information on this credit exposure.

### NUG Purchases (PPL Energy Supply and PPL Electric)

PPL Electric has a reciprocal contract with PPL EnergyPlus to sell electricity purchased under contracts with NUGs. PPL Electric purchases electricity from the NUGs at contractual rates and then sells the electricity at the same price to PPL EnergyPlus. These purchases totaled \$70 million in 2009, \$108 million in 2008 and \$156 million in 2007. These amounts are included in the Statements of Income as "Wholesale electric to affiliate" by PPL Electric, and as "Energy purchases from affiliate" by PPL Energy Supply.

### Allocations of Corporate Service Costs (PPL Energy Supply and PPL Electric)

PPL Services provides corporate functions such as financial, legal, human resources and information services. PPL Services charges the respective PPL subsidiaries for the cost of such services when they can be specifically identified. The cost of these services that is not directly charged to PPL subsidiaries is allocated to certain of the subsidiaries based on an average of the subsidiaries' relative invested capital, operation and maintenance expenses, and number of employees. PPL Services allocated the following amounts, which PPL management believes are reasonable, to PPL Energy Supply and PPL Electric, including amounts applied to accounts that are further distributed between capital and expense.

	<u>2009 (a)</u>		<u>2008</u>		<u>2007</u>	
PPL Energy Supply	\$	214	\$	209	\$	230
PPL Electric		121		116		112

(a) Excludes allocated costs associated with the February 2009 workforce reduction. See Note 12 for additional information.

### Intercompany Borrowings

*(PPL Energy Supply)*

A PPL Energy Supply subsidiary has an \$800 million demand note to an affiliate. There was no balance outstanding at December 31, 2009 and 2008. In 2009, interest was due monthly at a rate equal to 1-month LIBOR plus 1%. Interest earned on this note is included in "Interest Income from Affiliates" on the Statements of Income. While balances were outstanding, interest earned was \$4 million and \$12 million for 2008 and 2007. Interest was not significant for 2009.

*( PPL Electric)*

A PPL Electric subsidiary has a \$300 million demand note to an affiliate. There was no outstanding balance at December 31, 2009 and a \$300 million balance outstanding at December 31, 2008. The interest rate was equal to 3-month LIBOR plus 3.50% and 3-month LIBOR plus 1.00% at December 31, 2009 and 2008. This note is shown on the Balance Sheet as "Note receivable from affiliate." Interest earned on the note is included in "Interest Income from Affiliate" on the Statements of Income, and was \$4 million, \$9 million and \$19 million for 2009, 2008 and 2007.

**Intercompany Derivatives** *(PPL Energy Supply)*

In 2009, 2008 and 2007, PPL Energy Supply entered into a combination of average rate forwards and average rate options with PPL to sell British pounds sterling. These hedging instruments have terms identical to average rate forwards and average rate options entered into by PPL with third parties to protect the translation of expected income denominated in British pounds sterling to U.S. dollars. Gains and losses, both realized and unrealized, on these types of hedging instruments are included in "Other Income - net" on the Statements of Income. PPL Energy Supply recorded a net loss of \$9 million during 2009, a net gain of \$9 million during 2008 and a net loss of \$4 million during 2007 related to average rate forwards and average rate options. Contracts outstanding at December 31, 2009 hedge a total exposure of £48 million related to the translation of expected income for 2010. The fair value of these positions was a net asset of \$2 million, which is reflected in "Current Assets - Price risk management assets" on the Balance Sheet. No similar hedging instruments were outstanding at December 31, 2008.

In 2007, PPL Energy Supply entered into forward contracts with PPL to sell Chilean pesos. These hedging instruments had terms identical to forward sales contracts entered into by PPL with third parties to protect the value of its net investment in Emel, as well as a portion of the proceeds in excess of its net investment expected from the then-anticipated sale of Emel. These contracts were terminated in 2007 in connection with the sale of Emel. For 2007, PPL Energy Supply's Statement of Income reflects losses of \$7 million in "Other income - net" and \$23 million in Discontinued Operations related to these contracts.

PPL Energy Supply is also party to forward contracts with PPL to sell British pounds sterling to protect the value of a portion of its net investment in WPD. These hedging instruments have terms identical to forward sales contracts entered into by PPL with third parties. The total notional amount of the contracts outstanding at December 31, 2009 and 2008 was £40 million (approximately \$78 million based on contracted rates) and £68 million (approximately \$134 million based on contracted rates). The fair value of these positions was an asset of \$13 million and \$34 million at December 31, 2009 and 2008, which is included in the foreign currency translation adjustment component of AOCI on the Balance Sheets. Additionally, \$8 million and \$16 million were included in "Current Assets - Price risk management assets" on the Balance Sheets at December 31, 2009 and 2008 and \$5 million and \$18 million were included in "Other Noncurrent Assets - Price risk management assets" on the Balance Sheets at December 31, 2009 and 2008.

**Trademark Royalties** *(PPL Energy Supply)*

A PPL subsidiary owns PPL trademarks and bills certain affiliates for their use. PPL Energy Supply was allocated \$40 million of license fees in 2009, \$48 million in 2008 and \$39 million in 2007. These allocations are primarily included in "Other operation and maintenance" on the Statements of Income.

**Transmission** *(PPL, PPL Energy Supply and PPL Electric)*

PPL Energy Supply owns no domestic transmission or distribution facilities, other than facilities to interconnect its generation with the electric transmission system. Therefore, PPL EnergyPlus and other PPL Generation subsidiaries must pay PJM, the operator of the transmission system, to deliver the energy these subsidiaries supply to retail and wholesale customers in PPL Electric's franchised territory in eastern and central Pennsylvania. PJM in turn pays PPL Electric for the use of its transmission system. PPL eliminates the impact of these revenues and expenses on its Statements of Income.

**Other** *(PPL, PPL Energy Supply and PPL Electric)*

See Note 1 for discussions regarding the intercompany tax sharing policy and intercompany allocations of stock-based compensation expense. See Note 7 for a discussion regarding capital transactions between PPL and its affiliates. See Note 12 for discussions regarding intercompany allocations of defined benefits.

**16. Other Income - net**

*(PPL, PPL Energy Supply and PPL Electric)*

The breakdown of "Other Income - net" was:

2009

2008

2007

**PPL****Other Income**

Gains related to the extinguishment of notes (Note 7)	\$	29			
Earnings on securities in the NDT funds		20	\$	10	\$ 16
Interest income		14		33	61
Mine remediation liability adjustment				11	(2)
Hyder liquidation distributions				3	6
Gain (loss) on sales of PP&E				(1)	12
Miscellaneous - Domestic		11		7	12
Miscellaneous - International		1		1	9
<b>Total</b>		<u>75</u>		<u>64</u>	<u>114</u>

**Other Deductions**

Economic foreign currency hedges		9		(9)	8
Charitable contributions		6		5	6
Miscellaneous - Domestic		7		7	
Miscellaneous - International		4		6	3
<b>Total</b>	\$	<u>49</u>	\$	<u>55</u>	<u>97</u>

**Other Income - net****PPL Energy Supply****Other Income**

Gains related to the extinguishment of notes (Note 7)	\$	25			
Earnings on securities in the NDT funds		20	\$	10	\$ 16
Interest income		6		23	48
Mine remediation liability adjustment				11	(2)
Hyder liquidation distributions				3	6
Gain (loss) on sales of PP&E				1	8
Miscellaneous - Domestic		5		6	8
Miscellaneous - International		1		1	9
<b>Total</b>		<u>57</u>		<u>55</u>	<u>93</u>

**Other Deductions**

Economic foreign currency hedges		9		(9)	8
Miscellaneous - Domestic		9		10	2
Miscellaneous - International		4		6	3
<b>Total</b>	\$	<u>35</u>	\$	<u>48</u>	<u>80</u>

**Other Income - net****PPL Electric****Other Income**

Interest income	\$	8	\$	7	\$ 9
Gain on sales of PP&E					4
Miscellaneous					1
<b>Total</b>		<u>8</u>		<u>7</u>	<u>14</u>

**Other Deductions**

		<u>2</u>		<u>2</u>	<u>2</u>
<b>Total</b>	\$	<u>6</u>	\$	<u>5</u>	<u>12</u>

**Other Income - net****17. Fair Value Measurements and Credit Concentrations**

(PPL, PPL Energy Supply and PPL Electric)

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). Fair value guidance establishes a fair value hierarchy that prioritizes the inputs used to measure fair value into three broad levels. See Note 1 for additional information on fair value measurements. See Note 12 for more information regarding the fair value and related valuation techniques for retirement and postretirement benefit plan assets.

**Recurring Fair Value Measurements**

The assets and liabilities measured at fair value were:

	<u>December 31, 2009</u>			<u>December 31, 2008</u>		
	<u>Total</u>	<u>Fair Value Measurements Using</u>		<u>Total</u>	<u>Fair Value Measurements Using</u>	
		<u>Level 1</u>	<u>Level 2</u>		<u>Level 1</u>	<u>Level 2</u>
<b>PPL</b>						
Assets						
Cash and cash equivalents	\$ 801	\$ 801		\$ 1,100	\$ 1,100	

Short-term investments - municipal debt securities					150	150		
Restricted cash and cash equivalents	129	129			347	347		
Price risk management assets:								
Energy commodities	3,354	3	\$ 3,234	\$ 117	2,460	19	\$ 2,143	\$ 298
Interest rate/foreign currency exchange	77		77		156		152	4
	3,431	3	3,311	117	2,616	19	2,295	302
NDT funds:								
Cash and cash equivalents	7	7			4	4		
Equity securities:								
U.S. large-cap	259	176	83		182	116	66	
U.S. mid/small-cap	101	75	26		69	50	19	
Debt securities:								
U.S. Treasury	74	74			77	77		
U.S. government agency	9		9		14		14	
Municipality	65		65		61		61	
Investment-grade corporate	29		29		33		33	
Residential mortgage-backed securities	1		1		2		2	
Other					1		1	
Receivables/payables, net	3		3		3		3	
	548	332	216		446	247	199	
Auction rate securities	25			25	24			24
	<u>\$ 4,934</u>	<u>\$ 1,265</u>	<u>\$ 3,527</u>	<u>\$ 142</u>	<u>\$ 4,683</u>	<u>\$ 1,863</u>	<u>\$ 2,494</u>	<u>\$ 326</u>
<b>Liabilities</b>								
Price risk management liabilities:								
Energy commodities	\$ 2,080	\$ 2	\$ 2,068	\$ 10	\$ 2,133	\$ 15	\$ 2,008	\$ 110
Interest rate/foreign currency exchange	4		4		27		27	
	<u>\$ 2,084</u>	<u>\$ 2</u>	<u>\$ 2,072</u>	<u>\$ 10</u>	<u>\$ 2,160</u>	<u>\$ 15</u>	<u>\$ 2,035</u>	<u>\$ 110</u>
<b>PPL Energy Supply</b>								
Assets								
Cash and cash equivalents	\$ 245	\$ 245			\$ 464	\$ 464		
Short-term investments - municipal debt securities					150	150		
Restricted cash and cash equivalents	111	111			328	328		
Price risk management assets:								
Energy commodities	3,354	3	\$ 3,234	\$ 117	2,460	19	\$ 2,143	\$ 298
Interest rate/foreign currency exchange	27		27		107		103	4
	3,381	3	3,261	117	2,567	19	2,246	302
NDT funds:								
Cash and cash equivalents	7	7			4	4		
Equity securities:								
U.S. large-cap	259	176	83		182	116	66	
U.S. mid/small-cap	101	75	26		69	50	19	
Debt securities:								
U.S. Treasury	74	74			77	77		
U.S. government agency	9		9		14		14	
Municipality	65		65		61		61	
Investment-grade corporate	29		29		33		33	
Residential mortgage-backed securities	1		1		2		2	
Other					1		1	
Receivables/payables, net	3		3		3		3	
	548	332	216		446	247	199	
Auction rate securities	20			20	19			19
	<u>\$ 4,305</u>	<u>\$ 691</u>	<u>\$ 3,477</u>	<u>\$ 137</u>	<u>\$ 3,974</u>	<u>\$ 1,208</u>	<u>\$ 2,445</u>	<u>\$ 321</u>
<b>Liabilities</b>								
Price risk management liabilities:								
Energy commodities	\$ 2,080	\$ 2	\$ 2,068	\$ 10	\$ 2,133	\$ 15	\$ 2,008	\$ 110
Interest rate/foreign currency exchange	4		4		16		16	
	<u>\$ 2,084</u>	<u>\$ 2</u>	<u>\$ 2,072</u>	<u>\$ 10</u>	<u>\$ 2,149</u>	<u>\$ 15</u>	<u>\$ 2,024</u>	<u>\$ 110</u>

**PPL Electric**

Assets								
Cash and cash equivalents	\$	485	\$	485	\$	483	\$	483
Restricted cash and cash equivalents		14		14		15		15
	<u>\$</u>	<u>499</u>	<u>\$</u>	<u>499</u>	<u>\$</u>	<u>498</u>	<u>\$</u>	<u>498</u>

A reconciliation of net assets and liabilities classified as Level 3 is as follows.

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)															
	December 31, 2009				December 31, 2008											
	Energy Commodities, net	Interest Rate/ Foreign Currency Exchange	Auction Rate Securities	Total	Energy Commodities, net	Interest Rate/ Foreign Currency Exchange	Auction Rate Securities	Total								
<b>PPL</b>																
Balance at beginning of period	\$	188	\$	4	\$	24	\$	216	\$	134		\$	134			
Total realized/unrealized gains (losses)																
Included in earnings		(136)						(136)		2			2			
Included in OCI		18		(28)		5		(5)		11		\$	(5)	6		
Purchases, sales, issuances and settlements, net		104				(4)		100		2			(11)	(9)		
Transfers (out of) and/or into Level 3		(67)		24				(43)		39		\$	4	40	83	
Balance at end of period	<u>\$</u>	<u>107</u>	<u>\$</u>	<u></u>	<u>\$</u>	<u>25</u>	<u>\$</u>	<u>132</u>	<u>\$</u>	<u>188</u>	<u>\$</u>	<u>4</u>	<u>\$</u>	<u>24</u>	<u>\$</u>	<u>216</u>

**PPL Energy Supply**

Balance at beginning of period	\$	188	\$	4	\$	19	\$	211	\$	134		\$	134			
Total realized/unrealized gains (losses)																
Included in earnings		(136)						(136)		2			2			
Included in OCI		18		(28)		5		(5)		11		\$	(5)	6		
Purchases, sales, issuances and settlements, net		104				(4)		100		2			(11)	(9)		
Transfers (out of) and/or into Level 3		(67)		24				(43)		39		\$	4	35	78	
Balance at end of period	<u>\$</u>	<u>107</u>	<u>\$</u>	<u></u>	<u>\$</u>	<u>20</u>	<u>\$</u>	<u>127</u>	<u>\$</u>	<u>188</u>	<u>\$</u>	<u>4</u>	<u>\$</u>	<u>19</u>	<u>\$</u>	<u>211</u>

Net gains and losses on assets and liabilities classified as Level 3 and included in earnings are reported in the Statements of Income as follows.

	December 31, 2009				December 31, 2008									
	Energy Commodities, net				Energy Commodities, net									
	Wholesale Energy Marketing	Net Energy Trading Margins	Energy Purchases	Unregulated Retail Electric and Gas	Net Energy Trading Margins	Energy Purchases	Unregulated Retail Electric and Gas							
<b>PPL and PPL Energy Supply</b>														
Total gains (losses) included in earnings for the period	\$	22	\$	(16)	\$	(155)	\$	13	\$	(1)	\$	(3)	\$	6
Change in unrealized gains (losses) relating to positions still held at the reporting date		12		1		(83)		8		1		(3)		5

**Cash and Cash Equivalents, Short-term Investments, and Restricted Cash and Cash Equivalents**

The fair value of cash and cash equivalents and restricted cash and cash equivalents is based on the amount on deposit. The fair value measurements of short-term investments are based on quoted prices.

**Price Risk Management Assets/Liabilities - Energy Commodities**

The only energy commodity contracts classified as Level 1 are exchange-traded derivative gas and oil contracts. When observable inputs are used to measure all or most of the value of a contract, the contract is classified as Level 2. Over-the-counter (OTC) contracts are valued by users using quotes obtained from an exchange, binding and non-binding broker quotes, prices posted by ISOs or published tariff rates. PPL's risk management group obtains quotes from the market to validate the forward price curves. OTC contracts include forwards, swaps, options and structured deals for electricity, gas, oil, and/or emission allowances and may be offset with similar positions in exchange-traded markets. To the extent possible, fair value measurements utilize various inputs that include quoted prices for similar contracts or market-corroborated inputs. In certain instances, these instruments may be valued using models, including standard option valuation models and

standard industry models. For example, the fair value of a structured deal that delivers power to an illiquid delivery point may be measured by valuing the nearest liquid trading point plus the value of the basis between the two points. The basis input may be from market quotes, FTR prices, or historical prices.

When unobservable inputs are significant to the fair value measurement, a contract is classified as Level 3. Additionally, Level 2 and Level 3 fair value measurements include adjustments for credit risk based on PPL's own creditworthiness (for net liabilities) and its counterparties' creditworthiness (for net assets). PPL's credit department assesses all reasonably available market information and uses probabilities of default to calculate the credit adjustment. PPL assumes that observable market prices include sufficient adjustments for liquidity and modeling risks, but for Level 3 fair value measurements, PPL also assesses the need for additional adjustments for liquidity or modeling risks. The contracts classified as Level 3 represent contracts for which the delivery dates are beyond the dates for which independent prices are available or for certain power basis positions, which PPL generally values using historical prices.

#### Price Risk Management Assets/Liabilities - Interest Rate/Foreign Currency Exchange

To manage its interest rate and foreign currency exchange risk, PPL and PPL Energy Supply generally use interest rate contracts, such as forward-starting swaps and fixed-to-floating swaps; foreign currency exchange contracts, such as forwards and options; and cross-currency swaps that contain characteristics of both interest rate and foreign currency exchange contracts. PPL and PPL Energy Supply use an income approach to measure the fair value of these contracts, utilizing both observable inputs, such as forward interest rates and forward foreign currency exchange rates, and inputs that may not be observable, such as credit valuation adjustments. In certain cases, PPL and PPL Energy Supply cannot practicably obtain market information to value credit risk and therefore rely on their own models. These models use projected probabilities of default based on historical observances. When the credit valuation adjustment is significant to the overall valuation, the contracts are classified as Level 3.

#### NDT Funds

PPL and PPL Energy Supply generally use the market approach to measure the fair value of the securities held in the NDT funds. The fair value measurements of cash and cash equivalents are based on the amount on deposit. The fair value measurements of equity securities are based on quoted prices in active markets. The fair value measurements of commingled equity index funds are based on firm quotes of net asset values per share, which are not obtained from a quoted price in an active market. Equity securities are classified as Level 1 and are comprised of securities that are representative of the Wilshire 5000 index, which is invested in approximately 70% large-cap stocks and 30% mid/small-cap stocks. Investments in commingled equity funds are classified as Level 2 and represent securities that track the S&P 500 index and the Wilshire 4500 index. The fair value measurements of debt securities are generally based on evaluated prices that reflect observable market information, such as actual trade information for identical securities or for similar securities, adjusted for observable differences. When this information is not available, the fair value of debt securities is measured using present value techniques, which incorporate other observable inputs including interest rates for debt securities with credit ratings and terms to maturity similar to the debt securities being measured.

PPL and PPL Energy Supply recorded impairments of \$18 million in 2009, \$36 million in 2008 and \$3 million in 2007 for certain securities invested in the NDT funds. These impairments are reflected on the Statements of Income in "Other-Than-Temporary Impairments."

#### Auction Rate Securities

Prior to early 2008, auction rate securities had normally been remarketed on a short-term basis with auction dates commonly set at seven-day, 28-day, 35-day or 49-day intervals. Historically, an active market existed for such investments, and the auctions provided an opportunity for investors either to hold an investment at a periodically reset interest rate or to sell the investment at its par value for immediate liquidity. In early 2008, investor concerns about credit and liquidity in the financial markets, generally, as well as investor concerns over specific insurers that guarantee the credit of certain of the underlying securities, created uncertainty in the auction rate securities market and these securities generally failed to be remarketed through their established auction process. These auction failures and the resulting illiquidity continue to impact PPL's and PPL Energy Supply's auction rate securities. Despite failed auctions in 2008 and 2009, PPL and PPL Energy Supply continued to earn interest on these investments at contractually prescribed interest rates.

PPL and PPL Energy Supply estimates the fair value of auction rate securities based on the following criteria: (i) the underlying structure and credit quality of each security; (ii) the present value of future estimated interest and principal payments discounted using interest rates for bonds with a credit rating and remaining term to maturity similar to the stated maturity of the auction rate securities; and (iii) consideration of the impact of auction failures or redemption at par. The estimated fair value of these securities could change significantly based on future market conditions.

PPL's and PPL Energy Supply's auction rate securities are recorded in "Other investments" on the Balance Sheets. Based upon the evaluation of available information, PPL and PPL Energy Supply believe these investments, which include Federal Family Education Loan Program guaranteed student loan revenue bonds, as well as various municipal bond issues, continue to be of high credit quality. PPL and PPL Energy Supply do not have significant exposure to realize losses on these securities. However, auction rate securities are classified as Level 3 because failed auctions limit the amount of observable market data that is available for measuring the fair value of these securities.

At December 31, 2008, the par value of auction rate securities totaled \$29 million for PPL and \$24 million for PPL Energy Supply. At December 31, 2008, the fair value of auction rate securities was estimated to be \$24 million for PPL and \$19 million for PPL Energy Supply and the \$5 million temporary declines from par value were recorded to OCI.

In 2009, PPL and PPL Energy Supply liquidated \$4 million of securities at par. At December 31, 2009, the fair value of auction rate securities was estimated to be equal to par value, which was \$25 million for PPL and \$20 million for PPL Energy Supply, and the contractual maturities

for these securities was a weighted average of approximately 26 years. PPL and PPL Energy Supply reversed \$5 million of previously recorded temporary impairments by crediting OCI.

**Nonrecurring Fair Value Measurements** (PPL and PPL Energy Supply)

	Fair Value Measurements Using			
	Total	Level 2	Level 3	Loss
Sulfur dioxide emission allowances (a):				
March 31, 2009	\$ 15		\$ 15	\$ (30)
December 31, 2009	13		13	(7)
Long Island generation business (b):				
June 30, 2009	138	\$ 138		(52)
September 30, 2009	133	133		(5)
December 31, 2009	128	128		(5)

(a) Current and long-term sulfur dioxide emission allowances are included in "Other intangibles" in their respective areas on the Balance Sheet.

(b) Assets of the Long Island generation business disposal group are included in "Assets held for sale" on the Balance Sheet.

Sulfur Dioxide Emission Allowances

Due to a significant decline in market prices at March 31, 2009, PPL Energy Supply assessed the recoverability of sulfur dioxide emission allowances not expected to be consumed. As a result, emission allowances with a carrying amount of \$45 million were written down to their estimated fair value of \$15 million, resulting in an impairment charge of \$30 million being recorded during the first quarter of 2009. Due to a further decline in market prices and the reassessment of the quantity of emission allowances not expected to be consumed at December 31, 2009, PPL Energy Supply evaluated the recoverability of those allowances. As a result, emission allowances with a carrying amount of \$20 million were written down to their estimated fair value of \$13 million, resulting in an impairment charge of \$7 million being recorded during the fourth quarter of 2009. These charges, recorded in the Supply segment for PPL and PPL Energy Supply, are included in "Other operation and maintenance" on the Statement of Income.

When available, observable market prices were used to value the sulfur dioxide emission allowances. When observable market prices were not available, fair value was modeled using prices from observable transactions and appropriate discount rates. The modeled values were significant to the overall fair value measurement.

Long Island Generation Business

The Long Island generation business met the held for sale criteria in the second quarter of 2009. As a result, net assets held for sale with a carrying amount of \$189 million were written down to their estimated fair value (less cost to sell) of \$137 million at June 30, 2009. At both September 30 and December 31, 2009, the fair value (less cost to sell) was remeasured and additional impairments totaling \$10 million were recorded. In addition, \$2 million of goodwill allocated to this business was written off in 2009. See Note 9 for additional information on the anticipated sale.

The fair values in the table above exclude \$1 million of estimated costs to sell and were based on the negotiated sales price (achieved through an active auction process) adjusted for the additional anticipated cash flows from operations prior to and following the anticipated sale date. The sales price is consistent with and corroborated by fair values modeled internally using inputs obtained from third parties and appropriate discount rates.

**Financial Instruments Not Recorded at Fair Value** (PPL, PPL Energy Supply and PPL Electric)

NPNS

PPL and PPL Energy Supply enter into full-requirement sales contracts, power purchase agreements, certain retail energy and physical capacity contracts. These contracts range in maturity through 2023 and qualify for NPNS. PPL Electric has also entered into contracts that qualify for NPNS. See "Energy Purchase Commitments" within Note 14 for information about PPL Electric's competitive solicitations. All of these contracts are accounted for using accrual accounting; therefore, there were no amounts recorded on the Balance Sheets at December 31, 2009 and 2008. The estimated fair value of these contracts was:

	Net Asset (Liability)	
	December 31, 2009	December 31, 2008
PPL	\$ 122	\$ 136
PPL Energy Supply	334	239
PPL Electric	(216)	(103)

Other

Financial instruments for which the carrying amount on the Balance Sheets and the estimated fair value (based on quoted market prices for the



securities where available and estimates based on current rates where quoted market prices are not available) are different, are set forth below. The carrying value of "Collateral on PLR energy supply to/from affiliate" at December 31, 2008 and "Short-term debt" at December 31, 2009 and 2008 on the Balance Sheets represented or approximated fair value due to the liquid nature of the instruments or variable interest rates associated with the financial instruments.

	December 31, 2009 (a)		December 31, 2008	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>PPL</b>				
Long-term debt	\$ 7,143	\$ 7,280	\$ 7,838	\$ 6,785
<b>PPL Energy Supply</b>				
Long-term debt	5,031	5,180	5,196	4,507
<b>PPL Electric</b>				
Long-term debt	1,472	1,567	1,769	1,682

(a) The effect of third-party credit enhancements is not included in the fair value measurement. See "New Accounting Guidance Adopted - Issuer's Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement" within Note 1 for additional information.

### Credit Concentration Associated with Financial Instruments

*(PPL, PPL Energy Supply and PPL Electric)*

PPL and its subsidiaries enter into contracts with many entities for the purchase and sale of energy. Many of these contracts are considered a normal part of doing business and, as such, the fair value of these contracts is not reflected in the financial statements. However, the fair value of these contracts is considered when committing to new business from a credit perspective. See Note 18 for information on credit policies used by PPL and its subsidiaries to manage credit risk, including master netting arrangements and collateral requirements.

*(PPL)*

At December 31, 2009, PPL had credit exposure of \$3.6 billion to energy trading partners, excluding the effects of netting arrangements and collateral. As a result of netting arrangements and collateral, PPL's credit exposure was reduced to \$1.2 billion. One of the counterparties accounted for 23% of this exposure, and no other individual counterparty accounted for more than 13% of the exposure. Ten counterparties accounted for \$926 million, or 74%, of the net exposure. Nine of these counterparties had an investment grade credit rating from S&P and accounted for 97% of the top ten counterparty exposures. The remaining counterparty has not been rated by S&P, but is current on its obligations.

*(PPL Energy Supply)*

At December 31, 2009, PPL Energy Supply had credit exposure of \$3.6 billion to energy trading partners, excluding related parties and the effects of netting arrangements and collateral. As a result of netting arrangements and collateral, this credit exposure was reduced to \$1.2 billion. One of the counterparties accounted for 23% of this exposure, and no other individual counterparty accounted for more than 13% of the exposure. Ten counterparties accounted for \$926 million, or 74%, of the net exposure. Nine of these counterparties had an investment grade credit rating from S&P and accounted for 97% of the top ten counterparty exposures. The remaining counterparty has not been rated by S&P, but is current on its obligations.

At December 31, 2009, PPL Energy Supply's credit exposure under certain energy supply contracts to PPL Electric was \$203 million, excluding the effects of netting arrangements. As a result of netting arrangements, this credit exposure was unchanged.

*(PPL Electric)*

At December 31, 2009, PPL Electric had no credit exposure under energy supply contracts (including its supply contracts with its affiliate PPL EnergyPlus). All counterparties had an investment grade credit rating from S&P.

## 18. Derivative Instruments and Hedging Activities

### Risk Management Objectives *(PPL, PPL Energy Supply and PPL Electric)*

PPL has a risk management policy approved by the Board of Directors to manage market risk and counterparty credit risk. The RMC, comprised of senior management and chaired by the Chief Risk Officer, oversees the risk management function. Key risk control activities designed to ensure compliance with the risk policy and detailed programs include, but are not limited to, credit review and approval, validation of transactions and market prices, verification of risk and transaction limits, VaR analyses, portfolio stress tests, gross margin at risk analyses, sensitivity analyses, and daily portfolio reporting, including open positions, determinations of fair value, and other risk management metrics.

Market risk is the potential loss PPL and its subsidiaries may incur as a result of price changes associated with a particular financial or commodity instrument.

PPL and PPL Energy Supply are exposed to market risk from:

- commodity price basis and volumetric risks for energy and energy-related products associated with the sale of electricity from its generating assets and other electricity marketing activities and the purchase of fuel and fuel-related commodities for generating assets, as well as for proprietary trading activities; interest rate and price risk associated with debt used to finance operations, as well as debt and equity securities in NDT funds and defined benefit plans; and
- foreign currency exchange rate risk associated with investments in U.K. affiliates, as well as purchases of equipment in currencies other than U.S. dollars.

PPL and PPL Energy Supply utilize forward contracts, futures contracts, options, swaps and structured deals such as tolling agreements as part of the risk management strategy to minimize unanticipated fluctuations in earnings caused by changes in commodity prices, interest rates and foreign currency exchange rates. All derivatives are recognized on the balance sheet at their fair value, unless they qualify for NPNS.

PPL and PPL Electric are exposed to market price and volumetric risks from PPL Electric's obligation as the PLR to its customers. It has mitigated that risk with the fixed-price PLR agreement with PPL EnergyPlus, which expired at the end of 2009, and by entering into supply agreements for its customers for 2010 and 2011.

Credit risk is the potential loss PPL and its subsidiaries may incur due to a counterparty's non-performance, including defaults on payments and energy commodity deliveries.

PPL and PPL Energy Supply are exposed to credit risk from:

- commodity derivatives with its energy trading partners, which include other energy companies, fuel suppliers, and financial institutions;
- interest rate derivatives with financial institutions; and
- foreign currency derivatives with financial institutions.

PPL and PPL Electric are exposed to credit risk from PPL Electric's supply agreements for its customers for 2010 and 2011.

The majority of the credit risk stems from PPL Energy Supply's and PPL Electric's commodity derivatives for multi-year contracts for energy sales and purchases. If the counterparties fail to perform their obligations under such contracts and PPL and its subsidiaries could not replace the sales or purchases at the same prices as those under the defaulted contracts, PPL would incur financial losses. Those losses would be recognized immediately or through lower revenues or higher costs in future years, depending on the accounting treatment for the defaulted contracts.

*PPL and its subsidiaries have credit policies to manage their credit risk, including the use of an established credit approval process, daily monitoring of counterparty positions, and the use of master netting agreements. These agreements generally include credit mitigation provisions, such as margin, prepayment or collateral requirements. PPL and its subsidiaries may request the additional credit assurance, in certain circumstances, in the event that the counterparties' credit ratings fall below investment grade or their exposures exceed an established credit limit. See Note 17 for credit concentration associated with financial instruments.*

PPL's and PPL Energy Supply's obligation to return counterparty cash collateral under master netting arrangements was \$355 million and \$22 million at December 31, 2009 and 2008.

PPL Electric had no obligation to return cash collateral to PPL Energy Supply under master netting arrangements at December 31, 2009 and an obligation of \$300 million at December 31, 2008. See Note 15 for additional information.

At December 31, 2009, PPL, PPL Energy Supply and PPL Electric had not posted any cash collateral under master netting arrangements. At December 31, 2008, PPL and PPL Electric had not posted any cash collateral under master netting arrangements and PPL Energy Supply only had posted the \$300 million noted above.

#### **Commodity Price Risk (Non-trading) (PPL and PPL Energy Supply)**

Commodity price and basis risks are among PPL's and PPL Energy Supply's most significant risks due to the level of investment that PPL and PPL Energy Supply maintain in their generation assets, as well as the extent of their marketing and proprietary trading activities. Several factors influence price levels and volatilities. These factors include, but are not limited to, seasonal changes in demand, weather conditions, available generating assets within regions, transportation availability and reliability within and between regions, market liquidity, and the nature and extent of current and potential federal and state regulations.

To hedge the impact of market price fluctuations on PPL's and PPL Energy Supply's energy-related assets, liabilities and other contractual arrangements discussed above, PPL EnergyPlus sells and purchases physical energy at the wholesale level under FERC market-based tariffs throughout the U.S. and enters into financial exchange-traded and over-the-counter contracts. Certain contracts qualify for NPNS or are non-derivatives and are therefore not reflected in the financial statements until delivery. See Note 17 for additional information on NPNS. PPL and PPL Energy Supply segregate their remaining non-trading activities into two categories: cash flow hedge activity and economic activity.

#### Cash Flow Hedges

PPL and PPL Energy Supply enter into financial and physical derivative contracts, including forwards, futures, swaps and options, to hedge the

price risk associated with electricity, gas, oil and other commodities. Many of these contracts have qualified for hedge accounting. Contracts that existed at December 31, 2009 range in maturity through 2014. At December 31, 2009, the accumulated net unrealized after-tax gains on qualifying derivatives that are expected to be reclassified into earnings during the next 12 months were \$233 million for both PPL and PPL Energy Supply. Cash flow hedges are discontinued if it is no longer probable that the original forecasted transaction will occur by the end of the originally specified time periods and any amounts previously recorded in AOCI are reclassified to earnings. For 2009, 2008 and 2007, such reclassifications were an after-tax gain of \$9 million, an after-tax loss of \$8 million and an insignificant amount.

For 2009, 2008 and 2007, hedge ineffectiveness associated with energy derivatives was, after tax, a loss of \$174 million, a gain of \$310 million and a loss of \$3 million. Certain power and gas cash flow hedges failed hedge effectiveness testing in the third and fourth quarters of 2008, as well as the first quarter of 2009. Hedge accounting is not permitted for the quarter in which this occurs and, accordingly, the entire change in fair value for the periods that failed was recorded to the income statement. However, these transactions were not dedesignated as hedges, as prospective regression analysis demonstrated that these hedges are expected to be highly effective over their term. For 2008, an after-tax gain of \$298 million was recognized in earnings as a result of these hedge failures. During the second, third and fourth quarters of 2009, fewer power and gas cash flow hedges failed hedge effectiveness testing; therefore, a portion of the previously recognized unrealized gains recorded in the second half of 2008 and the first quarter of 2009 associated with these hedges were reversed. For 2009, after-tax losses of \$215 million were recognized in earnings as a result of these reversals.

### Economic Activity

PPL Energy Supply also uses derivative contracts to economically hedge the impact of market price fluctuations on its energy-related assets, liabilities and other contractual arrangements that do not receive hedge accounting treatment. PPL Energy Supply refers to these transactions as economic activity. The economic activity category includes energy derivative transactions that have previously qualified or could potentially qualify for hedge accounting; however, these transactions have either been disqualified from hedge accounting or management has not elected to designate them as accounting hedges. This activity includes the changes in fair value of positions used to hedge a portion of the economic value of PPL Energy Supply's generation assets, load-following and retail activities. This economic activity is subject to changes in fair value due to market price volatility of the input and output commodities (e.g., fuel and power). These contracts range in maturity through 2017. Additionally, premium amortization of \$53 million associated with options classified as economic activity and the ineffective portion of qualifying cash flow hedges, including the entire change in fair value for certain cash flow hedges that failed effectiveness testing during the current period as discussed in the preceding "Cash Flow Hedges" section, are also included in economic activity.

Examples of transactions represented in this category include certain purchase contracts used to supply full-requirement sales contracts; FTRs or basis swaps used to hedge basis risk associated with the sale of generation or supplying full-requirement sales contracts; spark spreads (sale of electricity with the simultaneous purchase of fuel); retail gas activities; and fuel oil swaps used to hedge price escalation clauses in coal transportation and other fuel-related contracts. PPL Energy Supply also uses options, which include the sale of call options and the purchase of put options tied to a particular generating unit. Since PPL Energy Supply owns the physical generating capacity, its price exposure is limited to the cost of the particular generating unit and does not expose PPL Energy Supply to uncovered market price risk. PPL Energy Supply also purchases call options or sells put options to create a net purchase position to cover an overall short position in its non-trading portfolio.

The gains (losses) for this activity are reflected in the Statements of Income as follows.

	<b>Gains (Losses)</b>		
	<b>2009</b>	<b>2008</b>	<b>2007</b>
Operating Revenues			
Unregulated retail electric and gas	\$ 6	\$ 5	
Wholesale energy marketing	(280)	1,056	\$ (145)
Operating Expenses			
Fuel	49	(79)	15
Energy purchases	(158)	(553)	185

The net gains (losses) recorded in "Wholesale energy marketing" resulted primarily from certain full-requirement sales contracts in which PPL Energy Supply did not elect NPNS and from hedge ineffectiveness, including hedges that failed effectiveness testing, as discussed in the "Cash Flow Hedges" section above. The net gains (losses) recorded in "Energy purchases" resulted primarily from certain purchase contracts to supply the full-requirement sales contracts noted above for which PPL Energy Supply did not elect hedge treatment and from hedge ineffectiveness, including hedges that failed effectiveness testing.

### **Commodity Price Risk (Trading) (PPL and PPL Energy Supply)**

PPL Energy Supply also executes energy contracts to take advantage of market opportunities. As a result, PPL Energy Supply may at times create a net open position in its portfolio that could result in significant losses if prices do not move in the manner or direction anticipated. PPL Energy Supply's trading activity is shown in "Net energy trading margins" on the Statements of Income.

### **Commodity Volumetric Activity (PPL and PPL Energy Supply)**

PPL Energy Supply currently employs four primary strategies to maximize the value of its wholesale energy portfolio. As further discussed below, these strategies include the sales of baseload generation, optimization of intermediate and peaking generation, marketing activities, and proprietary trading activities.

## Sales of Baseload Generation

PPL Energy Supply has a formal hedging program for its baseload generation fleet, which includes 7,370 MW of generating capacity. The objective of this program is to provide a reasonable level of near-term cash flow and earnings certainty for the next three years while preserving upside potential of power price increases over the medium term; however, in certain instances, PPL Energy Supply will sell power and purchase fuel beyond this three-year period. PPL Energy Supply sells its expected generation output on a forward basis using both derivative and non-derivative instruments. Both are included in the following tables.

The following table presents the expected sales, in GWh, of baseload generation based on current forecasted assumptions for 2010-2014. These expected sales could be impacted by several factors, including plant availability.

<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>
52,114	52,087	56,130	55,184	55,504

The following table presents the percentage of expected baseload generation sales shown above that has been sold forward under fixed-price contracts and the related percentage of fuel that has been purchased or committed at December 31, 2009.

<u>Year</u>	<u>Derivative Sales (a)</u>	<u>Total Power Sales (b)</u>	<u>Fuel Purchases (c)</u>	
			<u>Coal</u>	<u>Nuclear</u>
2010	91%	99%	99%	100%
2011	80%	88%	89%	100%
2012	48%	55%	70%	100%
2013	6%	13%	57%	100%
2014	1%	5%	51%	100%

- (a) Excludes non-derivative contracts and contracts that qualify for NPNS. Volumes for option contracts factor in the probability of an option being exercised and may be less than the notional amount of the option. Percentages are based on fixed-price contracts only.
- (b) Amount represents derivative and non-derivative contracts. Volumes for option contracts factor in the probability of an option being exercised and may be less than the notional amount of the option. Percentages are based on fixed-price contracts only.
- (c) Coal and nuclear contracts receive accrual accounting treatment, as they are not derivative contracts. Percentages are based on both fixed- and variable-priced contracts.

In addition to the fuel purchases above, PPL Energy Supply attempts to economically hedge the fuel price risk that is within its fuel-related contracts and coal transportation contracts, which are tied to changes in crude oil or diesel prices. The following table presents the volumes (in thousands of barrels) of derivative contracts used in support of this strategy at December 31, 2009.

<u>Contract Type</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
Oil Swaps	420	408	180

## Optimization of Intermediate and Peaking Generation

In addition to its baseload generation activities, PPL Energy Supply attempts to optimize the overall value of its intermediate and peaking fleet, which includes 4,349 MW of gas and oil-fired generation. PPL Energy Supply uses both option and non-option contracts to support this strategy. The following table presents the volumes of derivative contracts used in support of this strategy at December 31, 2009.

	<u>Units</u>	<u>2010</u>
Net Power Sales:		
Options (a)	GWh	507
Non-option contracts (b)	GWh	1,156
Net Fuel Sales:		
Non-option contracts (c)	Barrels	145,000
Net Power/Fuel Purchases:		
Non-option contracts	Bcf	9.3

- (a) Volumes for option contracts factor in the probability of an option being exercised and may be less than the notional amount of the option.
- (b) Included in these volumes are exercised option contracts that converted to non-option derivative contracts.
- (c) Represents the forward sale of physical oil inventory with a January 2010 delivery.

## Marketing Activities

PPL Energy Supply's marketing portfolio is comprised of full-requirement sales contracts and their related supply contracts, retail gas and electricity sales contracts and other marketing activities. The full-requirement sales contracts and their related supply contracts make up a significant component of the marketing portfolio. The obligations under the full-requirement sales contracts include supplying a bundled

product of energy, capacity, RECs, and other ancillary products. PPL Energy Supply uses a variety of strategies to hedge its full-requirement sales contracts, including purchasing energy at a liquid trading hub or directly at the load delivery zone, purchasing capacity and RECs in the market and supplying the energy, capacity and RECs with its generation. RECs are not derivatives and are excluded from the table below. The following table presents the volumes of (sales)/purchase contracts, excluding FTRs, basis and capacity contracts, used in support of these activities at December 31, 2009.

	<u>Units</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014 - 2019</u>
Energy sales contracts (a)	GWh	(32,866)	(14,693)	(4,364)	(2,233)	(10,122)
Related energy supply contracts						
Energy purchases	GWh	28,919	12,353	2,207	92	
Volumetric hedges (b)	GWh	170	218	48		
Volumetric hedges (b)	Bcf	(0.6)				
Generation Supply	GWh	3,327	2,240	2,232	2,135	10,122

- (a) The majority of PPL Energy Supply's full-requirement sales contracts receive accrual accounting as they qualify for NPNS or are not derivative contracts. Also included in these volumes are the sales from PPL EnergyPlus to PPL Electric to supply PPL Electric's 2010 PLR load obligation.
- (b) PPL Energy Supply uses power and gas options, swaps and futures to hedge the volumetric risk associated with full-requirement sales contracts since the demand for power varies hourly. Volumes for option contracts factor in the probability of an option being exercised and may be less than the notional amount of the option.

As noted above, PPL Energy Supply's marketing activities also include its retail gas portfolios. PPL Energy Supply has sold a total of 8.2 Bcf of gas to retail customers through 2012, all of which has been hedged with gas purchases.

#### FTRs and Other Basis Positions

PPL Energy Supply buys and sells FTRs and other basis positions to mitigate the basis risk between delivery points related to the sales of its generation, the supply of its full-requirement sales contracts and retail contracts, as well as for proprietary trading purposes. The following table presents the volumes of derivative FTR and basis (sales)/purchase contracts at December 31, 2009.

<u>Commodity</u>	<u>Units</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
FTRs	GWh	38,309	406	
Power Basis Positions	GWh	(19,086)	(861)	
Gas Basis Positions	Bcf	3.2	0.1	(0.3)

#### Capacity Positions

PPL Energy Supply buys and sells capacity related to the sales of its generation and the supply of its full-requirement sales contracts, as well as for proprietary trading purposes. The following table presents the volumes of derivative capacity (sales)/purchase contracts (in MW-months) at December 31, 2009.

<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014 - 2023 (a)</u>
(90,960)	(49,193)	(11,894)	1,626	2,720

- (a) 2,972 MW-months deliver in the 2014 to 2016 period.

#### Proprietary Trading Activity

At December 31, 2009, PPL Energy Supply's proprietary trading positions, excluding FTRs, basis and capacity contracts, were not significant.

#### **Interest Rate Risk (PPL and PPL Energy Supply)**

PPL and its subsidiaries have issued debt to finance its operations, which results in an exposure to interest rate risk. PPL and its subsidiaries utilize various financial derivative instruments to adjust the mix of fixed and floating interest rates in its debt portfolio, adjust the duration of its debt portfolio and lock in benchmark interest rates in anticipation of future financing, when appropriate. Risk limits under the risk management program are designed to balance risk exposure to volatility in interest expense and changes in the fair value of PPL's and its subsidiaries' debt portfolio due to changes in benchmark interest rates.

#### Cash Flow Hedges

Interest rate risks include exposure to adverse interest rate movements for outstanding variable rate debt and for future anticipated

financings. PPL and PPL Energy Supply may enter into financial interest rate swap contracts that qualify as cash flow hedges to hedge floating interest rate risk associated with both existing and anticipated debt issuances. For PPL, these interest rate swap contracts range in maturity through 2041 and had a notional value of \$425 million at December 31, 2009. For 2009, 2008 and 2007, hedge ineffectiveness associated with these derivatives was not significant. No contracts were outstanding at PPL Energy Supply at December 31, 2009.

WPDH Limited holds a net notional position in cross-currency swaps totaling \$302 million to hedge the interest payments and principal of its U.S. dollar-denominated senior notes with maturity dates ranging from December 2017 to December 2028. For 2009, 2008 and 2007, no amounts were recorded related to hedge ineffectiveness.

Cash flow hedges are discontinued if it is no longer probable that the original forecasted transaction will occur by the end of the originally specified time periods and any amounts previously recorded in AOCI are reclassified to earnings. PPL reclassified a net after-tax gain of \$1 million in 2009 and a net after-tax loss of \$3 million in 2007. PPL had no such reclassifications in 2008. PPL Energy Supply had no such reclassifications in 2009, 2008 and 2007.

At December 31, 2009, the accumulated net unrealized after-tax losses on qualifying derivatives that are expected to be reclassified into earnings during the next 12 months were \$1 million for PPL and insignificant for PPL Energy Supply. Amounts are reclassified as the hedged interest payments are made.

#### Fair Value Hedges

PPL and PPL Energy Supply are exposed to changes in the fair value of their domestic and international debt portfolios. To manage this risk, PPL and PPL Energy Supply may enter into financial contracts to hedge fluctuations in the fair value of existing debt issuances due to changes in benchmark interest rates. At December 31, 2009, PPL held contracts that range in maturity through 2047 and had a notional value of \$750 million. PPL Energy Supply did not hold any such contracts at December 31, 2009. PPL and PPL Energy Supply did not recognize any gains or losses resulting from the ineffective portion of fair value hedges or from a portion of the hedging instrument being excluded from the assessment of hedge effectiveness for 2009, 2008 and 2007. Additionally, PPL recognized a net after-tax gain of \$4 million from hedges of debt issuances that no longer qualified as fair value hedges for 2009, while the amounts were not significant for 2008 and 2007. PPL Energy Supply did not recognize any gains or losses resulting from hedges of debt issuances that no longer qualified as fair value hedges for 2009, 2008 and 2007.

#### **Foreign Currency Risk** (*PPL and PPL Energy Supply*)

PPL and PPL Energy Supply are exposed to foreign currency risk, primarily through investments in U.K. affiliates. In addition, PPL's and PPL Energy Supply's domestic operations may make purchases of equipment in currencies other than U.S. dollars.

PPL and PPL Energy Supply have adopted a foreign currency risk management program designed to hedge certain foreign currency exposures, including firm commitments, recognized assets or liabilities, anticipated transactions and net investments. In addition, PPL and PPL Energy Supply enter into financial instruments to protect against foreign currency translation risk of expected earnings.

#### Cash Flow Hedges

PPL and PPL Energy Supply may enter into foreign currency derivatives associated with foreign currency-denominated debt and the exchange rate associated with firm commitments denominated in foreign currencies; however, at December 31, 2009, there were no existing contracts of this nature. Amounts previously classified in AOCI are reclassified as the hedged interest payments are made and as the related equipment is depreciated.

Cash flow hedges are discontinued if it is no longer probable that the original forecasted transaction will occur by the end of the originally specified time periods and any amounts previously recorded in AOCI are reclassified to earnings. There were no such reclassifications during 2009, 2008 and 2007.

#### Fair Value Hedges

PPL and PPL Energy Supply enter into foreign currency forward contracts to hedge the exchange rates associated with firm commitments denominated in foreign currencies; however, at December 31, 2009, there were no existing contracts of this nature. PPL and PPL Energy Supply did not recognize any gains or losses resulting from the ineffective portion of fair value hedges or from a portion of the hedging instrument being excluded from the assessment of hedge effectiveness for 2009, 2008 and 2007. Additionally, PPL and PPL Energy Supply did not recognize any gains or losses resulting from hedges of firm commitments that no longer qualified as fair value hedges for 2009, 2008 and 2007.

#### Net Investment Hedges

PPL and PPL Energy Supply may enter into foreign currency contracts to protect the value of a portion of their net investment in WPD. The total notional amount of the contracts outstanding at December 31, 2009 was £40 million (approximately \$78 million based on contracted rates). The settlement dates of these contracts range from March 2010 through June 2011. At December 31, 2009, the fair value of these positions was a net asset of \$13 million. For 2009, 2008 and 2007, PPL and PPL Energy Supply recognized after tax net investment hedge losses of \$5 million, gains of \$20 million and \$2 million in the foreign currency translation adjustment component of OCI. At December 31, 2009, PPL and PPL Energy Supply had \$11 million of accumulated net investment hedge gains, after tax, that were included in the foreign currency translation adjustment component of AOCI compared with \$16 million of gains at December 31, 2008. See Note 15 for additional

information.

### Economic Activity

PPL and PPL Energy Supply may enter into foreign currency contracts as an economic hedge of anticipated earnings denominated in British pounds sterling. At December 31, 2009, the total exposure hedged was £48 million and the net fair value of these positions was a net asset of \$2 million. These contracts had termination dates ranging from January 2010 to June 2010. No similar hedging instruments were outstanding at December 31, 2008. Gains and losses, both realized and unrealized, on these contracts are included in "Other Income - net" on the Statements of Income. For 2009, PPL and PPL Energy Supply recorded net losses of \$9 million. For 2008 and 2007, PPL and PPL Energy Supply recorded net gains of \$9 million and net losses of \$4 million related to similar average rate forwards and average rate options. See Note 15 for additional information.

### **Accounting and Reporting**

*(PPL, PPL Energy Supply and PPL Electric)*

All derivative instruments are recorded at fair value on the balance sheet as an asset or liability (unless they qualify for NPNS), and changes in the derivatives' fair value are recognized currently in earnings unless specific hedge accounting criteria are met. See Note 17 for additional information on NPNS.

PPL and its subsidiaries have elected not to offset net derivative positions in the financial statements. Accordingly, PPL and its subsidiaries do not offset such derivative positions against the fair value of amounts (or amounts that approximate fair value) recognized for the right to reclaim cash collateral (a receivable) or the obligation to return cash collateral (a payable) under master netting arrangements.

Gains and losses associated with non-trading bilateral sales of electricity at major market delivery points are netted with purchases that offset the sales at those same delivery points. A major market delivery point is any delivery point with liquid pricing available.

PPL and PPL Energy Supply reflect their net realized and unrealized gains and losses associated with all derivatives that are held for trading purposes in the "Net energy trading margins" line on the Statements of Income.

The circumstances and intent existing at the time that derivative contracts are entered into are used to determine their accounting designation, which is subsequently verified by an independent internal group on a daily basis. The following summarizes the guidelines that have been provided to the marketers who are responsible for contract designation for derivative energy contracts.

Any wholesale and retail contracts to sell electricity and the related capacity that do not meet the definition of a derivative receive accrual accounting.

- Physical electricity-only transactions can receive cash flow hedge treatment if all of the qualifications are met.
- Physical capacity-only transactions to sell excess capacity from PPL's and PPL Energy Supply's generation qualify for NPNS. The forward value of these transactions is not recorded in the financial statements and has no earnings impact until delivery.
- Any physical energy sale or purchase not intended to hedge an economic exposure is considered speculative, with unrealized gains or losses recorded immediately through earnings.
- Financial transactions that can be settled in cash do not qualify for NPNS because they do not require physical delivery. These transactions can receive cash flow hedge treatment if they lock in the cash flows PPL and PPL Energy Supply will receive or pay for energy expected to be sold or purchased in the spot market.
- PPL and PPL Energy Supply purchase FTRs for both proprietary trading activities and hedging purposes. FTRs, although economically effective as electricity basis hedges, do not currently qualify for hedge accounting treatment. Unrealized and realized gains and losses from FTRs that were entered into for trading purposes are recorded in "Net energy trading margins" on the Statements of Income. Unrealized and realized gains and losses from FTRs that were entered into for hedging purposes are recorded in "Energy purchases" on the Statements of Income.
- Physical and financial transactions for gas and oil to meet fuel and retail requirements can receive cash flow hedge treatment if they lock in the price PPL and PPL Energy Supply will pay and meet the definition of a derivative.
- Certain option contracts may receive hedge accounting treatment. Those that are not eligible are marked to fair value through earnings.

Unrealized gains or losses on cash flow hedges are recorded in OCI, excluding ineffectiveness that is recognized immediately in earnings. These unrealized gains and losses become realized when the contracts settle and are recognized in earnings when the hedged transactions occur.

The following is a summary of certain guidelines that have been provided to PPL's Finance Department, which is responsible for contract designation for interest rate and foreign currency derivatives.

Transactions to lock in an interest rate prior to a debt issuance can be designated as cash flow hedges. Any unrealized gains or losses on

- transactions receiving cash flow hedge treatment are recorded in OCI and are amortized as a component of interest expense when the hedged transactions occur.
- Transactions entered into to hedge fluctuations in the fair value of existing debt can be designated as fair value hedges. To the extent that the change in the fair value of the derivative offsets the change in the fair value of the existing debt, there is no earnings impact, as both changes are reflected in interest expense. Realized gains and losses over the life of the hedge are reflected in interest expense.
- Transactions entered into to hedge the value of a net investment of foreign operations can be designated as net investment hedges. To the extent that the derivatives are highly effective at hedging the value of the net investment, gains and losses are recorded in the foreign currency translation adjustment component of OCI and will not be recorded in earnings until the investment is substantially liquidated.
- Derivative transactions that do not qualify for hedge accounting treatment are marked to fair value through earnings. These transactions generally include hedges of earnings translation risk associated with subsidiaries that report their financial statements in a currency other than the U.S. dollar. As such, these transactions eliminate earnings volatility due solely to changes in foreign currency exchange rates.

(PPL and PPL Energy Supply)

The following tables present the fair value and location of derivative instruments recorded on the Balance Sheets at December 31, 2009.

	PPL				PPL Energy Supply			
	Derivatives designated as hedging instruments		Derivatives not designated as hedging instruments (a)		Derivatives designated as hedging instruments		Derivatives not designated as hedging instruments (a)	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Current:								
Price Risk Management Assets/Liabilities (b)								
Interest rate swaps	\$ 10							
Cross-currency swaps contracts	1	\$ 4			\$ 1	\$ 4		
Foreign currency exchange contracts	8		\$ 2		8		\$ 2	
Commodity contracts	741	219	1,395	\$ 1,279	741	219	1,395	\$ 1,279
	<u>760</u>	<u>223</u>	<u>1,397</u>	<u>1,279</u>	<u>750</u>	<u>223</u>	<u>1,397</u>	<u>1,279</u>
Noncurrent:								
Price Risk Management Assets/Liabilities (b)								
Interest rate swaps	40							
Cross-currency swaps contracts	11				11			
Foreign currency exchange contracts	5				5			
Commodity contracts	578	118	640	464	578	118	640	464
	<u>634</u>	<u>118</u>	<u>640</u>	<u>464</u>	<u>594</u>	<u>118</u>	<u>640</u>	<u>464</u>
Total derivatives	<u>\$ 1,394</u>	<u>\$ 341</u>	<u>\$ 2,037</u>	<u>\$ 1,743</u>	<u>\$ 1,344</u>	<u>\$ 341</u>	<u>\$ 2,037</u>	<u>\$ 1,743</u>

(a) \$375 million of net gains associated with derivatives that were no longer designated as hedging instruments are recorded in AOCI at December 31, 2009.

(b) Represents the location on the balance sheet.

The after-tax balances of accumulated net gains (losses) (excluding net investment hedges) in AOCI were:

	2009	2008	2007
PPL	\$ 602	\$ (21)	\$ (192)
PPL Energy Supply	573	(12)	(188)

(PPL)

The following tables present the pre-tax effect of derivative instruments recognized in income or OCI in 2009.

Derivatives in Fair Value	Hedged Items in Fair Value Hedging	Location of Gains (Losses) Recognized in	Gain (Loss) Recognized in Income on Derivative	Gain (Loss) Recognized in
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<u>Hedging Relationships</u>	<u>Relationships</u>	<u>Income</u>	<u>Income on Related Item</u>
Interest rate swaps	Fixed rate debt	Interest expense Other income-net	\$ 12 \$ 29 7

<u>Derivative Relationships</u>	<u>Derivative Gain (Loss) Recognized in OCI (Effective Portion)</u>	<u>Location of Gains (Losses) Recognized in Income</u>	<u>Gain (Loss) Reclassified from AOCI into Income (Effective Portion)</u>	<u>Gain (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)</u>
Cash Flow Hedges:				
Interest rate swaps	\$ 64	Interest expense	\$ (2)	
		Other income - net	1	
Cross-currency swaps	(45)	Interest expense	2	
		Other income - net	(20)	
Commodity contracts	829	Wholesale energy marketing	358	\$ (296)
		Fuel	(20)	2
		Energy purchases	(544)	(7)
		Other operation and maintenance	1	
		Depreciation	1	
	<u>\$ 848</u>		<u>\$ (223)</u>	<u>\$ (301)</u>
Net Investment Hedges:				
Foreign currency exchange contracts	<u>\$ (9)</u>			

<u>Derivatives Not Designated as Hedging Instruments:</u>	<u>Location of Gains (Losses) Recognized in Income on Derivatives</u>	<u>2009</u>
Foreign currency exchange contracts	Other income - net	\$ (9)
Commodity contracts	Unregulated retail electric and gas	13
	Wholesale energy marketing	588
	Net energy trading margins (a)	
	Fuel	12
	Energy purchases	(808)
		<u>\$ (204)</u>

(a) Differs from statement of income due to intra-month transactions that PPL defines as spot activity, which is not accounted for as a derivative.

(PPL Energy Supply)

The following tables present the pre-tax effect of derivative instruments recognized in income or OCI in 2009.

<u>Derivatives in Fair Value Hedging Relationships</u>	<u>Hedged Items in Fair Value Hedging Relationships</u>	<u>Location of Gains (Losses) Recognized in Income</u>	<u>Gain (Loss) Recognized in Income on Derivative</u>	<u>Gain (Loss) Recognized in Income on Related Item</u>
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Interest rate swaps	Fixed rate debt	Interest expense	\$ 1	
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<u>Derivative Relationships</u>	<u>Derivative Gain (Loss) Recognized in OCI (Effective Portion)</u>	<u>Location of Gains (Losses) Recognized in Income</u>	<u>Gain (Loss) Reclassified from AOCI into Income (Effective Portion)</u>	<u>Gain (Loss) Recognized in Income on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)</u>
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Cash Flow Hedges:				
Interest rate swaps		Interest expense		
		Other income - net		
Cross-currency swaps	\$ (45)	Interest expense	\$ 2	
		Other income - net	(20)	
Commodity contracts	829	Wholesale energy marketing	358	\$ (296)

	Fuel	(20)	2
	Energy purchases	(544)	(7)
	Other operation and maintenance	1	
	Depreciation	1	
	<u>\$ 784</u>	<u>\$ (222)</u>	<u>\$ (301)</u>
Net Investment Hedges:			
Foreign currency exchange contracts	<u>\$ (9)</u>		

<u>Derivatives Not Designated as Hedging Instruments:</u>	<u>Location of Gains (Losses) Recognized in Income on Derivatives</u>	<u>2009</u>	
Foreign currency exchange contracts	Other income - net	\$	(9)
Commodity contracts	Unregulated retail electric and gas		13
	Wholesale energy marketing		588
	Net energy trading margins (a)		
	Fuel		12
	Energy purchases		(808)
		<u>\$</u>	<u>(204)</u>

(a) Differs from statement of income due to intra-month transactions that PPL Energy Supply defines as spot activity, which is not accounted for as a derivative.

#### Credit Risk-Related Contingent Features (PPL and PPL Energy Supply)

Certain of PPL's and PPL Energy Supply's derivative contracts contain credit contingent provisions which would permit the counterparties with which PPL or PPL Energy Supply is in a net liability position to require the transfer of additional collateral upon a decrease in PPL's or PPL Energy Supply's credit rating. Most of these provisions would require PPL or PPL Energy Supply to transfer additional collateral or permit the counterparty to terminate the contract if PPL's or PPL Energy Supply's credit rating were to fall below investment grade. Some of these provisions also would allow the counterparty to require additional collateral upon each decrease in the credit rating at levels that remain above investment grade. In either case, if PPL's or PPL Energy Supply's credit rating were to fall below investment grade (i.e., below BBB- for S&P or Fitch, or Baa3 for Moody's), and assuming no assignment to an investment grade affiliate were allowed, most of these credit contingent provisions require either immediate payment of the net liability as a termination payment or immediate and ongoing full collateralization by PPL or PPL Energy Supply on derivative instruments in net liability positions.

Additionally, certain of PPL's and PPL Energy Supply's derivative contracts contain credit contingent provisions that require PPL or PPL Energy Supply to provide "adequate assurance" of performance if the other party has reasonable grounds for insecurity regarding PPL's or PPL Energy Supply's performance of its obligation under the contract. A counterparty demanding adequate assurance could require a transfer of additional collateral or other security, including letters of credit, cash and guarantees from a creditworthy entity. This would typically involve negotiations among the parties. However, amounts disclosed below represent assumed immediate payment or immediate and ongoing full collateralization for derivative instruments in net liability positions with "adequate assurance" provisions.

To determine net liability positions, PPL and PPL Energy Supply use the fair value of each agreement. The aggregate fair value of all derivative instruments with the credit contingent provisions described above that were in a net liability position at December 31, 2009 was \$197 million for both PPL and PPL Energy Supply, of which both had posted collateral of \$163 million in the normal course of business. At December 31, 2009, if the credit contingent provisions underlying these derivative instruments were triggered due to a credit downgrade below investment grade, PPL and PPL Energy Supply would have been required to post an additional \$131 million of collateral to their counterparties.

#### 19. Goodwill and Other Intangible Assets

##### Goodwill (PPL and PPL Energy Supply)

The changes in the carrying amount of goodwill by segment were:

	<u>Supply</u>		<u>International Delivery</u>		<u>Total</u>	
	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>	<u>2009</u>	<u>2008</u>
Balance at beginning of period (a)	\$ 94	\$ 94	\$ 669	\$ 897	\$ 763	\$ 991
Allocation to discontinued operations (b)	(3)				(3)	
Effect of foreign currency exchange rates			46	(228)	46	(228)
Balance at end of period	<u>\$ 91</u>	<u>\$ 94</u>	<u>\$ 715</u>	<u>\$ 669</u>	<u>\$ 806</u>	<u>\$ 763</u>

(a) There were no accumulated impairment losses related to goodwill recorded at January 1, 2008.

(b) Allocated to the Long Island and the majority of the Maine hydroelectric generation businesses and written off.

## Other Intangibles

(PPL)

he gross carrying amount and the accumulated amortization of other intangible assets were:

	December 31, 2009		December 31, 2008	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
<b>Subject to amortization:</b>				
Land and transmission rights	\$ 272	\$ 114	\$ 244	\$ 110
Emission allowances/ RECs (a) (b)	56		88	
Lease arrangement and other (c)	375	41	372	23
<b>Not subject to amortization due to indefinite life:</b>				
Land and transmission rights	16		16	
Easements	76		67	
	<u>\$ 795</u>	<u>\$ 155</u>	<u>\$ 787</u>	<u>\$ 133</u>

- (a) Removed from the Balance Sheets and expensed when consumed or sold. Consumption expense was \$32 million, \$25 million, and \$108 million in 2009, 2008, and 2007. Consumption expense is estimated at \$26 million for 2010, \$8 million for 2011, \$2 million for 2012 and \$1 million for 2013 and 2014.
- (b) During 2009, PPL recorded \$37 million of impairment charges. See Note 17 for additional information.
- (c) "Other" includes costs for the development of licenses, the most significant of which is the COLA. Amortization of these costs begins when the related asset is placed in service. See Note 8 for additional information on the COLA.

Current intangible assets and long-term intangible assets are included in "Other intangibles" in their respective areas on the Balance Sheets.

Amortization expense, excluding consumption of emission allowances/RECs, was \$22 million, \$13 million and \$7 million in 2009, 2008 and 2007, and is estimated to be \$23 million per year for 2010 through 2014.

(PPL Energy Supply)

The gross carrying amount and the accumulated amortization of other intangible assets were:

	December 31, 2009		December 31, 2008	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
<b>Subject to amortization:</b>				
Land and transmission rights	\$ 59	\$ 23	\$ 42	\$ 22
Emission allowances/ RECs (a) (b)	56		88	
Lease arrangement and other (c)	375	41	372	23
<b>Not subject to amortization due to indefinite life:</b>				
Easements	76		67	
	<u>\$ 566</u>	<u>\$ 64</u>	<u>\$ 569</u>	<u>\$ 45</u>

- (a) Removed from the Balance Sheets and expensed when consumed or sold. Consumption expense was \$32 million, \$25 million, and \$108 million in 2009, 2008, and 2007. Consumption expense is estimated at \$26 million for 2010, \$8 million for 2011, \$2 million for 2012 and \$1 million for 2013 and 2014.
- (b) During 2009, PPL Energy Supply recorded \$37 million of impairment charges. See Note 17 for additional information.
- (c) "Other" includes costs for the development of licenses, the most significant of which is the COLA. Amortization of these costs begins when the related asset is placed in service. See Note 8 for additional information on the COLA.

Current intangible assets and long-term intangible assets are presented as "Other intangibles" in their respective areas on the Balance Sheets.

Amortization expense, excluding consumption of emission allowances/RECs, was \$19 million, \$10 million and \$4 million in 2009, 2008 and 2007, and is estimated to be \$20 million per year for 2010 through 2014.

(PPL Electric)

The gross carrying amount and the accumulated amortization of intangible assets were:

	December 31, 2009		December 31, 2008	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
<b>Subject to amortization:</b>				
Land and transmission rights	\$ 214	\$ 91	\$ 203	\$ 89
<b>Not subject to amortization due to indefinite life:</b>				
Land and transmission rights	16		16	
	<u>\$ 230</u>	<u>\$ 91</u>	<u>\$ 219</u>	<u>\$ 89</u>

Intangible assets are shown as "Intangibles" on the Balance Sheets.

Amortization expense was \$3 million for 2009 and 2008 and \$2 million for 2007, and is estimated to be \$3 million per year for 2010 through 2014.

(PPL, PPL Energy Supply and PPL Electric)

The annual provisions for amortization have been computed principally in accordance with the following weighted-average asset lives (in years):

	Weighted-Average Life
Land and transmission rights	67
Emission allowances/RECs (a)	
Lease arrangement and other	21

(a) Expensed when consumed or sold.

Following are the weighted-average rates of amortization at December 31.

	2009	2008
Land and transmission rights	1.23%	1.28%
Emission allowances/RECs (a)		
Lease arrangement and other	6.09%	6.10%

(a) Expensed when consumed or sold.

(PPL and PPL Energy Supply)

In November 2009, the NRC approved PPL Susquehanna's application for 20-year license renewals for each of the Susquehanna nuclear units. Costs of \$17 million were capitalized related to these license renewals. The weighted-average period prior to the next PPL Susquehanna license renewal is 34 years. See Note 8 for additional information.

## 20. Asset Retirement Obligations

(PPL and PPL Energy Supply)

PPL and PPL Energy Supply recognized, as liabilities in the financial statements, various legal obligations associated with the retirement of long-lived assets, the largest of which relates to the decommissioning of the Susquehanna plant. Other AROs recorded relate to significant interim retirements at the Susquehanna plant and various environmental requirements for coal piles, ash basins and other waste basin retirements.

PPL and PPL Energy Supply have recorded several conditional AROs, the most significant of which related to the removal and disposal of asbestos-containing material.

In addition to the AROs that were recorded for asbestos-containing material, PPL and PPL Energy Supply identified other asbestos-related obligations, but were unable to reasonably estimate their fair values. These retirement obligations could not be reasonably estimated due to indeterminable settlement dates. The generation plants, where significant amounts of asbestos-containing material are located, have been well maintained and large capital and environmental investments are being made at these plants. During the previous five years, the useful lives of the plants had been reviewed and in most cases significantly extended. Due to these circumstances, PPL management was unable to reasonably estimate a settlement date or range of settlement dates for the remediation of all of the asbestos-containing material at the generation plants. If economic events or other circumstances change that enable PPL and PPL Energy Supply to reasonably estimate the fair value of these retirement obligations, they will be recorded at that time.

Other conditional AROs that were recorded related to treated wood poles, gas-filled switchgear and fluid-filled cables. These obligations, required by U.K. law, had an insignificant impact on the financial statements.

PPL and PPL Energy Supply also identified legal retirement obligations associated with the retirement of a reservoir and certain transmission assets that could not be reasonably estimated due to indeterminable settlement dates.

Current AROs are included in "Other current liabilities" and long-term AROs are included in "Asset retirement obligations" on the Balance Sheets. The changes in the carrying amounts of AROs were:

	<u>2009</u>	<u>2008</u>
ARO at beginning of period	\$ 389	\$ 376
Accretion expense	31	29
New obligations incurred	9	12
Change in estimated cash flow or settlement date	16	(4)
Change in foreign currency exchange rates		(2)
Obligations settled	<u>(19)</u>	<u>(22)</u>
ARO at end of period	<u>\$ 426</u>	<u>\$ 389</u>

Changes in ARO costs and settlement dates, which affect the carrying value of various AROs, are reviewed periodically to ensure that any material changes are incorporated into the latest estimates of the obligation. In 2009, PPL Energy Supply revised cost estimates for several AROs and recognized additional asbestos liabilities at several plants, the most significant being the asbestos AROs at the Montour plant. In 2008, PPL Energy Supply revised estimated settlement dates and cost estimates for remediating several AROs, the most significant being the ash basins at the Montour and Brunner Island plants. In addition, PPL Energy Supply recognized additional liabilities for asbestos-containing material at several plants. The effect of these new and revised liabilities was to increase the ARO liability and related plant balances by \$25 million in 2009 and \$8 million in 2008. The 2009 and 2008 income statement impact of these changes was insignificant.

The most significant ARO recorded by PPL and PPL Energy Supply relates to the decommissioning of the Susquehanna nuclear plant. The expected cost to decommission the Susquehanna plant is based on a 2002 site-specific study that estimated the cost to dismantle and decommission each unit immediately following final shutdown. PPL Susquehanna's 90% share of the total estimated cost of decommissioning the Susquehanna plant was approximately \$936 million measured in 2002 dollars. This estimate includes decommissioning the radiological portions of the station and the cost of removal of non-radiological structures and materials. In 2010, PPL Energy Supply plans to perform a site-specific study to estimate the cost to decommission each unit. The impact of this study on the recorded ARO is not now determinable, but could be significant.

The accrued nuclear decommissioning obligation was \$348 million and \$322 million at December 31, 2009 and 2008, and is included in "Asset retirement obligations" on the Balance Sheets. The fair value of investments that are legally restricted for the decommissioning of the Susquehanna nuclear plant was \$548 million and \$446 million at December 31, 2009 and 2008, and is included in "Nuclear plant decommissioning trust funds" on the Balance Sheets. See Notes 17 and 21 for additional information on the nuclear decommissioning trust funds. Accretion expense, associated with the obligation, was \$26 million in 2009, \$24 million in 2008 and \$22 million in 2007, and is included in "Other operation and maintenance" on the Statements of Income.

*(PPL and PPL Electric)*

PPL Electric has identified legal retirement obligations for the retirement of certain transmission assets that could not be reasonably estimated due to indeterminable settlement dates. These assets are located on rights-of-way that allow the grantor to require PPL Electric to relocate or remove the assets. Since this option is at the discretion of the grantor of the right-of-way, PPL Electric is unable to determine when these events may occur.

## 21. Available-for-Sale Securities

*(PPL, PPL Energy Supply and PPL Electric)*

PPL and its subsidiaries classify auction rate securities, certain short-term investments and securities held by the NDT funds as available-for-sale. Available-for-sale securities are carried on the balance sheet at fair value. Unrealized gains and losses on these securities are reported, net of tax, in OCI or are recognized currently in earnings when a decline in fair value is determined to be other-than-temporary.

(PPL and PPL Energy Supply)

The following table shows the amortized cost of available-for-sale securities and the gross unrealized gains and losses recorded in AOCI at December 31. See Note 17 for information regarding the fair value of these securities.

	2009			2008		
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (a)
<b>PPL</b>						
Short-term investments – municipal debt securities				\$ 150		
NDT funds:						
Cash and cash equivalents	\$ 7			4		
Equity securities:						
U.S. large-cap	170	\$ 89		160	\$ 22	
U.S. mid/small-cap	65	36		60	9	
Debt securities:						
U.S. Treasury	72	2		67	10	
U.S. government agency	9			13	1	
Municipality	63	2		59	2	
Investment-grade corporate	28	1		31	2	
Residential mortgage-backed securities	1			2		
Other				1		
Receivables/Payables, net	3			3		
	<u>418</u>	<u>130</u>		<u>400</u>	<u>46</u>	
Auction rate securities	25			29		\$ (5)
Total PPL	<u>\$ 443</u>	<u>\$ 130</u>		<u>\$ 579</u>	<u>\$ 46</u>	<u>\$ (5)</u>

**PPL Energy Supply**

Short-term investments – municipal debt securities				\$ 150		
NDT funds:						
Cash and cash equivalents	\$ 7			4		
Equity securities:						
U.S. large-cap	170	\$ 89		160	\$ 22	
U.S. mid/small-cap	65	36		60	9	
Debt securities:						
U.S. Treasury	72	2		67	10	
U.S. government agency	9			13	1	
Municipality	63	2		59	2	
Investment-grade corporate	28	1		31	2	
Residential mortgage-backed securities	1			2		
Other				1		
Receivables/Payables, net	3			3		
	<u>418</u>	<u>130</u>		<u>400</u>	<u>46</u>	
Auction rate securities	20			24		\$ (5)
Total PPL Energy Supply	<u>\$ 438</u>	<u>\$ 130</u>		<u>\$ 574</u>	<u>\$ 46</u>	<u>\$ (5)</u>

(a) Prior to the April 1, 2009 adoption of accounting guidance addressing other-than-temporary impairments, there were no unrealized losses recorded in AOCI on debt securities in the NDT funds. See "New Accounting Guidance Adopted - Recognition and Presentation of Other-Than-Temporary Impairments" in Note 1 for additional information.

There were no securities with gross unrealized losses not recognized in earnings at December 31, 2009. At December 31, 2008, the fair value of PPL's and PPL Energy Supply's auction rate securities in an unrealized loss position for less than 12 months was \$21 million and \$19 million. The gross unrealized losses on these securities were \$5 million for PPL and PPL Energy Supply.

The following table shows the scheduled maturity dates of debt securities held at December 31, 2009.

	Maturity Less Than 1 Year	Maturity 1-5 Years	Maturity 5-10 Years	Maturity in Excess of 10 Years	Total
<b>P</b>					
Amortized Cost	\$ 7	\$ 79	\$ 49	\$ 63	\$ 198
Fair Value	7	81	51	64	203

**PPL Energy Supply**

Amortized Cost	\$	7	\$	79	\$	49	\$	58	\$	193
Fair Value		7		81		51		59		198

The following table shows proceeds from and realized gains (losses) on sales of available-for-sale securities.

		2009		2008		2007
<b>PPL</b>						
Proceeds from sales of NDT securities (a)	\$	201	\$	197	\$	175
Other proceeds from sales		154		126		648
Gross realized gains (b)		27		19		15
Gross realized losses (b)		(20)		(23)		(10)
<b>PPL Energy Supply</b>						
Proceeds from sales of NDT securities (a)	\$	201	\$	197	\$	175
Other proceeds from sales		154		33		584
Gross realized gains (b)		27		19		15
Gross realized losses (b)		(20)		(23)		(10)

(a) These proceeds, along with deposits of amounts collected from customers, are used to pay income taxes and fees related to managing the trust. Remaining proceeds are reinvested in the trust.

(b) Excludes the impact of other-than-temporary impairment charges recognized in the Statements of Income.

**NDT Funds**

Beginning in January 1999 and ending in December 2009, in accordance with the PUC Final Order, approximately \$130 million of decommissioning costs were recovered from PPL Electric's customers through the CTC over the 11-year life of the CTC rather than the remaining life of the Susquehanna nuclear plant. The recovery included a return on unamortized decommissioning costs. Under the power supply agreements between PPL Electric and PPL EnergyPlus, these revenues were passed on to PPL EnergyPlus. Similarly, these revenues were passed on to PPL Susquehanna under a power supply agreement between PPL EnergyPlus and PPL Susquehanna.

Amounts collected from PPL Electric's customers for decommissioning, less applicable taxes, are deposited in external trust funds for investment and can only be used for future decommissioning costs. To the extent that the actual costs for decommissioning exceed the amounts in the nuclear decommissioning trust funds, PPL Susquehanna would be obligated to fund 90% of the shortfall.

When the fair value of a security is less than amortized cost, PPL and PPL Energy Supply must make certain assertions to avoid recording an other-than-temporary impairment that requires a current period charge to earnings. The NRC requires that nuclear decommissioning trusts be managed by independent investment managers, with discretion to buy and sell securities in the trusts. As a result, PPL and PPL Energy Supply have been unable to demonstrate the ability to hold an impaired security until it recovers its value; therefore, unrealized losses on debt securities through March 31, 2009 and unrealized losses on equity securities for all periods presented, represented other-than-temporary impairments that required a current period charge to earnings.

As described in "New Accounting Guidance Adopted - Recognition and Presentation of Other-Than-Temporary Impairments" in Note 1, effective April 1, 2009, when PPL and PPL Energy Supply intend to sell a debt security or more likely than not will be required to sell a debt security before recovery, then the other-than-temporary impairment recognized in earnings will equal the entire difference between the security's amortized cost basis and its fair value. However, if there is no intent to sell a debt security and it is not more likely than not that they will be required to sell the security before recovery, but the security has suffered a credit loss, the other-than-temporary impairment will be separated into the credit loss component, which is recognized in earnings, and the remainder of the other-than-temporary impairment, which is recorded in OCI. Temporary impairments of debt securities and unrealized gains on both debt and equity securities are recorded to OCI. There were no credit losses on debt securities held in the NDT funds at December 31, 2009.

**Auction Rate Securities**

At December 31, 2009 and 2008, auction rate securities were recorded in "Other investments" on the Balance Sheets. Historically, the fair value of auction rate securities approximated their par value due to the frequent resetting of the interest rates through the auction process. The auctions for these outstanding securities failed in 2008 and 2009. Based upon the evaluation of available information, PPL and PPL Energy Supply believe these investments continue to be of high credit quality and they do not have significant exposure to realize losses on these securities. PPL and PPL Energy Supply continue to earn interest on these investments at contractually prescribed interest rates. PPL and PPL Energy Supply have no current plans to sell these securities until they can be liquidated at par value and do not anticipate having to sell these securities in order to fund operations or for any other purpose. As such, the decline in fair value noted below was deemed temporary due to general market conditions.

At December 31, 2008, the estimated fair value of the auction rate securities was \$5 million lower than par value for PPL and PPL Energy Supply. In 2008, unrealized losses of \$5 million for both PPL and PPL Energy Supply were recorded to OCI. During 2009, PPL Energy Supply liquidated \$4 million of these securities at par. At December 31, 2009, the estimated fair value was determined to approximate par value. As such, PPL and PPL Energy Supply reversed \$5 million of previously recorded temporary impairments. See Note 17 for additional information on these securities, including fair value.

## Short-term Investments

*(PPL and PPL Energy Supply)*

In December 2008, the PEDFA issued \$150 million aggregate principal amount of Exempt Facilities Revenue Bonds, Series 2008A and 2008B due 2038 (Series 2008 Bonds) on behalf of PPL Energy Supply. PPL Investment Corp. acted as the initial purchaser of the Series 2008 Bonds upon issuance. At December 31, 2008, these investments were reflected in "Short-term investments" on the Balance Sheet. In April 2009, PPL Investment Corp. received \$150 million for its investment in the Series 2008 bonds when they were refunded by the PEDFA. See "Long-term Debt" in Note 7 for more information on the refundings. No realized or unrealized gains (losses) were recorded on these securities, as the difference between carrying value and fair value was insignificant.

*(PPL and PPL Electric)*

In October 2008, the PEDFA issued \$90 million aggregate principal amount of Pollution Control Revenue Refunding Bonds, Series 2008 (PPL Electric Utilities Corporation Project) due 2023 (PPL Electric Series 2008 Bonds) on behalf of PPL Electric. PPL Electric acted as the initial purchaser of the PPL Electric Series 2008 Bonds upon issuance. PPL Electric remarketed the PPL Electric Series 2008 Bonds to unaffiliated investors in November 2008. No realized or unrealized gains (losses) were recorded in 2008 related to these securities, as the difference between carrying value and fair value was insignificant.

## **22. New Accounting Guidance Pending Adoption**

*(PPL, PPL Energy Supply and PPL Electric)*

### **Accounting for Transfers of Financial Assets**

Effective January 1, 2010, PPL and its subsidiaries will adopt accounting guidance that was issued to revise the accounting for transfers of financial assets. This guidance:

- eliminates the concept of a qualifying special-purpose entity (QSPE); therefore, QSPEs will be subject to consolidation guidance;
- changes the requirements for the derecognition of financial assets;
- establishes new criteria for reporting the transfer of a portion of a financial asset as a sale;
- requires transferors to initially recognize, at fair value, assets obtained and liabilities incurred as a result of a transfer accounted for as a sale; and
- requires enhanced disclosures to improve the transparency around transfers of financial assets and a transferor's continuing involvement.

Early adoption is prohibited. This guidance will be applied prospectively to new transfers of financial assets. Disclosures will be required for all transfers, including those entered into before the effective date. Comparative disclosures are encouraged, but not required, for periods in which these disclosures were not previously required. The January 1, 2010 adoption is not expected to have a significant impact on PPL and its subsidiaries; however, the impact in future periods could be material.

### **Consolidation of Variable Interest Entities**

Effective January 1, 2010, PPL and its subsidiaries will adopt accounting guidance that was issued to replace the quantitative-based risks and rewards calculation for determining which entity, if any, has a controlling financial interest in a variable interest entity (VIE) and is the primary beneficiary. The primary beneficiary must consolidate the VIE. This guidance:

- prescribes a qualitative approach focused on identifying which entity has the power to direct the activities of a VIE that most significantly impact the VIE's economic performance and the obligation to absorb losses of or the right to receive benefits from the VIE that could potentially be significant to the VIE;
- requires ongoing assessments of whether an entity is the primary beneficiary of a VIE;
- requires enhanced disclosures to improve the transparency of an entity's involvement in a VIE;
- requires that all previous consolidation conclusions be reconsidered; and
- requires that QSPEs be evaluated for consolidation (resulting from the elimination of the QSPE concept in the guidance addressing accounting for transfers of financial assets).

If the initial application results in consolidation of a VIE, the assets, liabilities and noncontrolling interests of the VIE will be measured at their carrying amounts as if this guidance had been applied from the point in time the entity became the primary beneficiary of the VIE (unless the fair value option is elected). Any difference between the net amounts required to be recognized and the amount of any previously recognized interest will be reflected as a cumulative-effect adjustment to retained earnings. If initial application results in deconsolidation of a VIE, any retained interest in the VIE will be measured at its carrying value as if this guidance had been applied from the inception of the VIE.

Early adoption is prohibited. Comparative disclosures are not required for periods in which these disclosures were not previously required. PPL and its subsidiaries are assessing the potential impact of adoption to the financial statements. The January 1, 2010 adoption is not expected to have a significant impact on PPL and its subsidiaries; however, the impact in future periods could be material.

### **Improving Disclosures about Fair Value Measurements**



Effective January 1, 2010, PPL and its subsidiaries will prospectively adopt accounting guidance that was issued to improve disclosures about fair value measurements. This guidance:

- requires disclosures be provided for each class of assets and liabilities, with class determined on the basis of the nature and risks of the assets and liabilities;
- for recurring fair value measurements, requires disclosure of significant transfers between Levels 1 and 2 and transfers into and out of Level 3 and the reasons for those transfers; and
- clarifies that a description of valuation techniques and inputs used to measure fair value is required for Level 2 and Level 3 recurring and nonrecurring fair value measurements.

Effective January 1, 2011, PPL and its subsidiaries will adopt provisions of this guidance that require Level 3 activity of purchases, sales, issuances and settlements be provided on a gross basis.

This guidance makes corresponding amendments to employers' disclosures about pensions and other postretirement benefits.

Early adoption is permitted. Comparative disclosures are required only for periods ending after initial adoption. PPL and its subsidiaries are assessing the potential impact of adoption. The adoption could have a significant impact on required disclosures.

### **Subsequent Measurement - Cash Flow Hedges**

Effective April 1, 2010, PPL and its subsidiaries will prospectively adopt accounting guidance that was issued to clarify how an entity should reflect the subsequent measurement of cash flow hedges in AOCI if, during a prior period, hedge accounting was not permitted. This situation may arise if an entity's retrospective assessment of hedge effectiveness indicated that the hedging relationship had not been highly effective in a period, but the prospective assessment of hedge effectiveness showed an expectation that the hedging relationship would be highly effective in the future; therefore, the hedging relationship continued even though hedge accounting was not permitted for a certain period. This guidance:

- requires that the cumulative gain or loss on the derivative that is used to determine the maximum amount of gain or loss that may be reflected in AOCI exclude the gains or losses that occurred during the period when hedge accounting was not permitted; and
- requires that the cumulative change in the expected future cash flows on the hedged transaction exclude the changes related to the period when hedge accounting was not applied.

PPL and its subsidiaries are assessing the potential impact of adoption. The potential impact of adoption is not yet determinable but could be material.

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**QUARTERLY FINANCIAL, COMMON STOCK PRICE AND DIVIDEND DATA (Unaudited)**

**PPL Corporation and Subsidiaries**

*Millions of Dollars, except per share data*

	For the Quarters Ended (a)			
	March 31	June 30	Sept. 30	Dec. 31
<b>2009</b>				
Operating revenues as previously reported	\$ 2,359			
Reclassification of discontinued operations (b)	(8)			
Operating revenues	2,351	\$ 1,673	\$ 1,805	\$ 1,727
Operating income as previously reported	417			
Reclassification of discontinued operations (b)	(5)			
Operating income	412	104	181	264
Income from continuing operations after income taxes as previously reported	246			
Reclassification of discontinued operations (b)	(3)			
Income from continuing operations after income taxes	243	29	50	144
Income (loss) from discontinued operations as previously reported				
Reclassification of discontinued operations (b)	3			
Income (loss) from discontinued operations	3	(32)	(24)	13
Net income (loss)	246	(3)	26	157
Net income attributable to PPL	241	(7)	20	153
Income from continuing operations after income taxes available to PPL common shareowners: (c)				
Basic EPS	0.64	0.07	0.12	0.37
Diluted EPS	0.64	0.07	0.12	0.37
Net income available to PPL common shareowners: (c)				
Basic EPS	0.64	(0.02)	0.05	0.40
Diluted EPS	0.64	(0.02)	0.05	0.40
Dividends declared per share of common stock (d)	0.345	0.345	0.345	0.345
Price per common share:				
High	\$ 33.54	\$ 34.42	\$ 34.21	\$ 33.05
Low	24.25	27.40	28.27	28.82
<b>2008</b>				
Operating revenues	\$ 1,516	\$ 1,014	\$ 2,971	\$ 2,506
Operating income	473	385	384	551
Income from continuing operations after income taxes	247	189	210	281
Income (loss) from discontinued operations	18	6	(2)	1
Net income	265	195	208	282
Net income attributable to PPL	260	190	203	277
Income from continuing operations after income taxes available to PPL common shareowners: (c)				
Basic EPS	0.64	0.49	0.54	0.73
Diluted EPS	0.64	0.49	0.54	0.73
Net income available to PPL common shareowners: (c)				
Basic EPS	0.69	0.50	0.54	0.74
Diluted EPS	0.69	0.50	0.54	0.74
Dividends declared per share of common stock (d)	0.335	0.335	0.335	0.335
Price per common share:				
High	\$ 55.23	\$ 54.00	\$ 53.78	\$ 37.88
Low	44.72	46.04	34.95	26.84

- (a) Quarterly results can vary depending on, among other things, weather and the forward pricing of power. In addition, earnings in 2009 and 2008 were affected by special items. Accordingly, comparisons among quarters of a year may not be indicative of overall trends and changes in operations. These special items include \$24 million of tax expense recorded in the third quarter of 2009 for the correction to the previously computed tax bases of the Latin American businesses that were sold in 2007. See Note 9 to the Financial Statements for additional information.
- (b) In 2009, PPL Generation signed a definitive agreement to sell its Long Island generation business and PPL Maine sold the majority of its hydroelectric generation business. See Note 9 to the Financial Statements for additional information on these transactions and other completed sales.
- (c) The sum of the quarterly amounts may not equal annual earnings per share due to changes in the number of common shares outstanding during the year or rounding.
- (d) PPL has paid quarterly cash dividends on its common stock in every year since 1946. Future dividends, declared at the discretion of the Board of Directors, will be dependent upon future earnings, cash flows, financial requirements and other factors.

**QUARTERLY FINANCIAL DATA (Unaudited)**  
**PPL Energy Supply, LLC and Subsidiaries**  
*( Millions of Dollars )*

	<b>For the Quarters Ended (a)</b>			
	<b>March 31</b>	<b>June 30</b>	<b>Sept. 30</b>	<b>Dec. 31</b>
<b>2009</b>				
Operating revenues as previously reported	\$ 1,964			
Reclassification of discontinued operations (b)	<u>(8)</u>			
Operating revenues	1,956	\$ 1,356	\$ 1,456	\$ 1,364
Operating income as previously reported	300			
Reclassification of discontinued operations (b)	<u>(5)</u>			
Operating income	295	34	91	167
Income from continuing operations after income taxes as previously reported	191			
Reclassification of discontinued operations (b)	<u>(3)</u>			
Income from continuing operations after income taxes	188	1	9	89
Income (loss) from discontinued operations as previously reported				
Reclassification of discontinued operations (b)	<u>3</u>			
Income (loss) from discontinued operations	3	(32)	(24)	13
Net income (loss)	191	(31)	(15)	102
Net income (loss) attributable to PPL Energy Supply	191	(31)	(16)	102
<b>2008</b>				
Operating revenues	\$ 1,124	\$ 670	\$ 2,610	\$ 2,131
Operating income	357	300	274	441
Income from continuing operations after income taxes	195	153	158	244
Income (loss) from discontinued operations	9	5	3	3
Net income	204	158	161	247
Net income attributable to PPL Energy Supply	204	157	161	246

- (a) Quarterly results can vary depending on, among other things, weather and the forward pricing of power. In addition, earnings in 2009 and 2008 were affected by special items. Accordingly, comparisons among quarters of a year may not be indicative of overall trends and changes in operations. These special items include \$24 million of tax expense recorded in the third quarter of 2009 by for the correction to the previously computed tax bases of the Latin American businesses that were sold in 2007. See Note 9 to the Financial Statements for additional information.
- (b) In 2009, PPL Generation signed a definitive agreement to sell its Long Island generation business and PPL Maine sold the majority of its hydroelectric generation business. See Note 9 to the Financial Statements for additional information on these transactions and other completed sales.

**QUARTERLY FINANCIAL DATA (Unaudited)**  
**PPL Electric Utilities Corporation and Subsidiaries**  
*(Millions of Dollars)*

		<b>For the Quarters Ended (a)</b>			
		<b>March 31</b>	<b>June 30</b>	<b>Sept. 30</b>	<b>Dec. 31</b>
	<b>2009 (b)</b>				
Operating revenues		\$ 910	\$ 747	\$ 809	\$ 826
Operating income		106	61	78	84
Net income		54	21	32	35
Income available to PPL		49	17	27	31
	<b>2008</b>				
Operating revenues		\$ 908	\$ 800	\$ 842	\$ 851
Operating income		111	78	87	99
Net income		56	36	41	43
Income available to PPL		51	32	36	39

- (a) PPL Electric's business is seasonal in nature, with peak sales periods generally occurring in the winter and summer months. In addition, earnings in 2009 were affected by special items. Accordingly, comparisons among quarters of a year may not be indicative of overall trends and changes in operations.
- (b) During the second quarter of 2009, PPL Electric recorded an \$8 million reduction to operating revenues and a \$5 million reduction to net income and income available to PPL as a result of a true-up for the FERC formula-based transmission revenues for 2008 and the first quarter of 2009.
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**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS  
ON ACCOUNTING AND FINANCIAL DISCLOSURE**

**PPL Corporation, PPL Energy Supply, LLC and PPL Electric Utilities Corporation**

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**ITEM 9A. CONTROLS AND PROCEDURES**

**PPL Corporation, PPL Energy Supply, LLC and PPL Electric Utilities Corporation**

(a) Evaluation of disclosure controls and procedures.

The registrants' principal executive officers and principal financial officers, based on their evaluation of the registrants' disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934) have concluded that, as of December 31, 2009, the registrants' disclosure controls and procedures are effective to ensure that material information relating to the registrants and their consolidated subsidiaries is recorded, processed, summarized and reported within the time periods specified by the SEC's rules and forms, particularly during the period for which this annual report has been prepared. The aforementioned principal officers have concluded that the disclosure controls and procedures are also effective to ensure that information required to be disclosed in reports filed under the Exchange Act is accumulated and communicated to management, including the principal executive and principal financial officers, to allow for timely decisions regarding required disclosure.

(b) Changes in internal control over financial reporting.

The registrants' principal executive officers and principal financial officers have concluded that there were no changes in the registrants' internal control over financial reporting during the registrants' fourth fiscal quarter that have materially affected, or are reasonably likely to materially affect, the registrants' internal control over financial reporting.

**Management's Report on Internal Control over Financial Reporting**

**PPL Corporation**

PPL's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). PPL's internal control over financial reporting is a process designed to provide reasonable assurance to PPL's management and Board of Directors regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements.

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in "Internal Control - Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in "Internal Control - Integrated Framework," our management concluded that our internal control over financial reporting was effective as of December 31, 2009. The effectiveness of our internal control over financial reporting has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report contained on page 90.

**ITEM 9A(T). CONTROLS AND PROCEDURES**

**PPL Energy Supply, LLC and PPL Electric Utilities Corporation**

Management of PPL's non-accelerated filer companies, PPL Energy Supply and PPL Electric, is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). PPL's internal control over financial reporting is a process designed to provide reasonable assurance to PPL's management and Board of Directors regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements.

Under the supervision and with the participation of our management, including our principal executive officers and principal financial officers, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in "Internal Control - Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in "Internal Control - Integrated Framework," our management concluded that our internal control over financial reporting was effective as of December 31, 2009. This annual report does not include an attestation report of Ernst & Young LLP, the companies' independent registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the companies' registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the companies to provide only management's report in this annual report.

**ITEM 9B. OTHER INFORMATION**

**PPL Corporation, PPL Energy Supply, LLC and PPL Electric Utilities Corporation**

None.

### **PART III**

#### **ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

##### **PPL Corporation**

Additional information for this item will be set forth in the sections entitled "Nominees for Directors," "Directors Continuing in Office," "Board Committees - Audit Committee" and "Section 16(a) Beneficial Ownership Reporting Compliance" in PPL's 2010 Notice of Annual Meeting and Proxy Statement, which will be filed with the SEC not later than 120 days after December 31, 2009, and which information is incorporated herein by reference. There have been no changes to the procedures by which shareowners may recommend nominees to PPL's board of directors since the filing with the SEC of PPL's 2009 Notice of Annual Meeting and Proxy Statement. Information required by this item concerning the executive officers of PPL is set forth at the end of Part I of this report.

PPL has adopted a code of ethics entitled "Standards of Conduct and Integrity" that applies to all directors, managers, trustees, officers (including the principal executive officers, principal financial officers and principal accounting officers (each, a "principal officer")), employees and agents of PPL and PPL's subsidiaries for which it has operating control (including PPL Energy Supply and PPL Electric). The "Standards of Conduct and Integrity" are posted on PPL's Internet Web site: [www.pplweb.com/about/corporate+governance](http://www.pplweb.com/about/corporate+governance). A description of any amendment to the "Standards of Conduct and Integrity" (other than a technical, administrative or other non-substantive amendment) will be posted on PPL's Internet Web site within four business days following the date of the amendment. In addition, if a waiver constituting a material departure from a provision of the "Standards of Conduct and Integrity" is granted to one of the principal officers, a description of the nature of the waiver, the name of the person to whom the waiver was granted and the date of the waiver will be posted on PPL's Internet Web site within four business days following the date of the waiver.

PPL also has adopted its "Guidelines for Corporate Governance," which address, among other things, director qualification standards and director and board committee responsibilities. These guidelines, and the charters of each of the committees of PPL's board of directors, are posted on PPL's Internet Web site: [www.pplweb.com/about/corporate+governance](http://www.pplweb.com/about/corporate+governance).

##### **PPL Energy Supply, LLC**

Item 10 is omitted as PPL Energy Supply meets the conditions set forth in General Instruction (I)(1)(a) and (b) of Form 10-K.

##### **PPL Electric Utilities Corporation**

Additional information for this item will be set forth in the sections entitled "Nominees for Directors," "Board Committees," and "Section 16(a) Beneficial Ownership Reporting Compliance" in PPL Electric's 2010 Notice of Annual Meeting and Information Statement, which will be filed with the SEC not later than 120 days after December 31, 2009, and which information is incorporated herein by reference. PPL Electric's parent, PPL, has adopted a code of ethics entitled "Standards of Conduct and Integrity," which applies to all directors, managers, officers (including the principal executive officers, principal financial officers and principal accounting officers), employees and agents of PPL Electric and its subsidiaries. The full text of the "Standards of Conduct and Integrity" is posted in the Corporate Governance section of PPL's Internet Web site: [www.pplweb.com/about/corporate+governance](http://www.pplweb.com/about/corporate+governance). Information required by this item concerning the executive officers of PPL Electric is set forth at the end of Part I of this report.

#### **ITEM 11. EXECUTIVE COMPENSATION**

##### **PPL Corporation**

Information for this item will be set forth in the sections entitled "Compensation of Directors," "Compensation Committee Interlocks and Insider Participation" and "Executive Compensation" in PPL's 2010 Notice of Annual Meeting and Proxy Statement, which will be filed with the SEC not later than 120 days after December 31, 2009, and which information is incorporated herein by reference.

##### **PPL Energy Supply, LLC**

Item 11 is omitted as PPL Energy Supply meets the conditions set forth in General Instruction (I)(1)(a) and (b) of Form 10-K.

##### **PPL Electric Utilities Corporation**

Information for this item will be set forth in the sections entitled "Compensation of Directors" and "Executive Compensation" in PPL Electric's 2010 Notice of Annual Meeting and Information Statement, which will be filed with the SEC not later than 120 days after December 31, 2009, and which information is incorporated herein by reference.

#### **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

##### **PPL Corporation**

Information for this item will be set forth in the section entitled "Stock Ownership" in PPL's 2010 Notice of Annual Meeting and Proxy Statement, which will be filed with the SEC not later than 120 days after December 31, 2009, and which information is incorporated herein by reference. In addition, provided below in tabular format is information as of December 31, 2009, with respect to compensation plans (including individual compensation arrangements) under which equity securities of PPL are authorized for issuance.

### **Equity Compensation Plan Information**

	Number of securities to be issued upon exercise of outstanding options, warrants and rights (3)	Weighted-average exercise price of outstanding options, warrants and rights (3)	Number of securities remaining available for future issuance under equity compensation plans (4)
Equity compensation plans approved by security holders (1)	2,778,235 - ICP 1,823,806 - ICPKE 4,602,041 - Total	\$33.03 - ICP \$31.92 - ICPKE \$32.59 - Combined	3,458,171 - ICP 9,840,240 - ICPKE 14,578,022 - DDCP 27,876,433 - Total
Equity compensation plans not approved by security holders (2)			

- (1) Includes (a) the Amended and Restated Incentive Compensation Plan (ICP), under which stock options, restricted stock, restricted stock units, performance units, dividend equivalents and other stock-based awards may be awarded to executive officers of PPL; (b) the Amended and Restated Incentive Compensation Plan for Key Employees (ICPKE), under which stock options, restricted stock, restricted stock units, performance units, dividend equivalents and other stock-based awards may be awarded to non-executive key employees of PPL and its subsidiaries; and (c) the Directors Deferred Compensation Plan (DDCP), under which stock units may be awarded to directors of PPL. See Note 11 to the financial statements for additional information.
- (2) All of PPL's current compensation plans under which equity securities of PPL are authorized for issuance have been approved by PPL's shareowners.
- (3) Relates to common stock issuable upon the exercise of stock options awarded under the ICP and ICPKE as of December 31, 2009. In addition, as of December 31, 2009, the following other securities had been awarded and are outstanding under the ICP, ICPKE and DDCP: 45,400 shares of restricted stock, 416,840 restricted stock units and 101,139 performance units under the ICP; 24,600 shares of restricted stock, 921,202 restricted stock units and 65,324 performance units under the ICPKE; and 406,584 stock units under the DDCP.
- (4) Based upon the following aggregate award limitations under the ICP, ICPKE and DDCP: (a) under the ICP, 15,769,430 awards (i.e., 5% of the total PPL common stock outstanding as of April 23, 1999) granted after April 23, 1999; (b) under the ICPKE, 16,573,608 awards (i.e., 5% of the total PPL common stock outstanding as of January 1, 2003) granted after April 25, 2003, reduced by outstanding awards for which common stock was not yet issued as of such date of 2,373,812 resulting in a limit of 14,199,796; and (c) under the DDCP, 15,052,856 securities. In addition, each of the ICP and ICPKE includes an annual award limitation of 2% of total PPL common stock outstanding as of January 1 of each year.

#### **PPL Energy Supply, LLC**

Item 12 is omitted as PPL Energy Supply meets the conditions set forth in General Instruction (I)(1)(a) and (b) of Form 10-K.

#### **PPL Electric Utilities Corporation**

Information for this item will be set forth in the section entitled "Stock Ownership" in PPL Electric's 2010 Notice of Annual Meeting and Information Statement, which will be filed with the SEC not later than 120 days after December 31, 2009, and which information is incorporated herein by reference.

### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

#### **PPL Corporation**

Information for this item will be set forth in the sections entitled "Transactions with Related Persons" and "Independence of Directors" in PPL's 2010 Notice of Annual Meeting and Proxy Statement, which will be filed with the SEC not later than 120 days after December 31, 2009, and is incorporated herein by reference.

#### **PPL Energy Supply, LLC**

Item 13 is omitted as PPL Energy Supply meets the conditions set forth in General Instruction (I)(1)(a) and (b) of Form 10-K.

#### **PPL Electric Utilities Corporation**

Information for this item will be set forth in the sections entitled "Transactions with Related Persons" and "Nominations" in PPL Electric's 2010 Notice of Annual Meeting and Information Statement, which will be filed with the SEC not later than 120 days after December 31, 2009,

and is incorporated herein by reference.

#### **ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

##### **PPL Corporation**

Information for this item will be set forth in the section entitled "Fees to Independent Auditor for 2009 and 2008" in PPL's 2010 Notice of Annual Meeting and Proxy Statement, which will be filed with the SEC not later than 120 days after December 31, 2009, and which information is incorporated herein by reference.

##### **PPL Energy Supply, LLC**

The following table presents an allocation of fees billed, including expenses, by Ernst & Young LLP (EY) to PPL for the fiscal years ended December 31, 2009 and 2008, for professional services rendered for the audit of PPL Energy Supply's annual financial statements and for fees billed for other services rendered by EY.

	<u>2009</u>	<u>2008</u>
	(in thousands)	
Audit fees (a)	\$ 2,621	\$ 3,031
Audit-related fees (b)	31	111
Tax fees (c)		
All other fees (d)	8	64

- (a) Includes estimated fees for audit of annual financial statements and review of financial statements included in PPL Energy Supply's Quarterly Reports on Form 10-Q and for services in connection with statutory and regulatory filings or engagements, including comfort letters and consents for financings and filings made with the SEC.
- (b) Fees for due diligence work, a review of eXtensible Business Reporting Language tags assigned to financial statement line items and for consultation to ensure appropriate accounting and reporting in connection with various business and financing transactions.
- (c) The independent auditor did not provide tax services to PPL Energy Supply or any of its affiliates.
- (d) Fees related to access to an EY online accounting research tool, an audit of grant applications relating to network connections, consultation with outside counsel regarding U.K. GAAP and miscellaneous regulatory consulting services.

Approval of Fees The Audit Committee of PPL has procedures for pre-approving audit and non-audit services to be provided by the independent auditor. These procedures are designed to ensure the continued independence of the independent auditor. More specifically, the use of the independent auditor to perform either audit or non-audit services is prohibited unless specifically approved in advance by the Audit Committee of PPL. As a result of this approval process, the Audit Committee of PPL has established specific categories of services and authorization levels. All services outside of the specified categories and all amounts exceeding the authorization levels are reviewed by the Chair of the Audit Committee of PPL, who serves as the Committee designee to review and approve audit and non-audit related services during the year. A listing of the approved audit and non-audit services is reviewed with the full Audit Committee of PPL no later than its next meeting.

The Audit Committee of PPL approved 100% of the 2009 and 2008 services provided by EY.

##### **PPL Electric Utilities Corporation**

Information for this item will be set forth in the section entitled "Fees to Independent Auditor for 2009 and 2008" in PPL Electric's 2010 Notice of Annual Meeting and Information Statement, which will be filed with the SEC not later than 120 days after December 31, 2009, and which information is incorporated herein by reference.

#### **PART IV**

#### **ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES**

##### **PPL Corporation, PPL Energy Supply, LLC and PPL Electric Utilities Corporation**

(a) The following documents are filed as part of this report:

1. Financial Statements - Refer to the "Index to Item 8. Financial Statements and Supplementary Data" for an index of the financial statements included in this report.
2. Supplementary Data and Supplemental Financial Statement Schedule - included in response to Item 8.



All supplemental financial statement schedules are omitted because of the absence of the conditions under which they are required or because the required information is included in the financial statements or notes thereto.

3. Exhibits

See Exhibit Index immediately following the signature pages.

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## **SHAREOWNER AND INVESTOR INFORMATION**

**Annual Meetings :** The 2010 annual meeting of shareowners of PPL will be held on Wednesday, May 19, 2010, at the Holiday Inn in Fogelsville, Pennsylvania, in Lehigh County. The 2010 meeting for PPL Electric will be held on Thursday, May 20, 2010, at the offices of the company at Two North Ninth Street, Allentown, Pennsylvania.

**Proxy and Information Statement Material :** A proxy statement or information statement, and notice of PPL's and PPL Electric's annual meetings are mailed to all shareowners of record as of February 26, 2010.

**PPL Annual Report :** The report is published and mailed in the beginning of April to all shareowners of record. The latest annual report can be accessed at [www.pplweb.com](http://www.pplweb.com). If you have more than one account, or if there is more than one investor in your household, you may call the PPL Shareowner Information Line to request that only one annual report be delivered to your address. Please provide account numbers for all duplicate mailings.

**Dividends :** Subject to the declaration of dividends on PPL common stock by the PPL Board of Directors or its Executive Committee and PPL Electric preferred stock and preference stock by the PPL Electric Board of Directors, dividends are paid on the first business day of April, July, October and January. The 2010 record dates for dividends are expected to be March 10, June 10, September 10, and December 10.

**Direct Deposit of Dividends:** Shareowners may choose to have their dividend checks deposited directly into their checking or savings account.

**PPL Shareowner Information Line (1-800-345-3085):** Shareowners can get detailed corporate and financial information 24 hours a day using the PPL Shareowner Information Line. They can hear timely recorded messages about earnings, dividends and other company news releases; request information by fax; and request printed materials in the mail. Other PPL publications, such as the annual and quarterly reports to the Securities and Exchange Commission (Forms 10-K and 10-Q), will be mailed upon request, or write to:

Manager - PPL Investor Services  
Two North Ninth Street (GENTW13)  
Allentown, PA 18101

FAX: 610-774-5106  
Via email: [invserv@pplweb.com](mailto:invserv@pplweb.com)

**PPL's Web Site ([www.pplweb.com](http://www.pplweb.com)):** Shareowners can access PPL Securities and Exchange Commission filings, corporate governance materials, news releases, stock quotes and historical performance. Visitors to our Web site can provide their email address and indicate their desire to receive future earnings or news releases automatically.

### **Shareowner Inquiries :**

PPL Shareowner Services  
Wells Fargo Bank, N.A.  
161 North Concord Exchange  
South St. Paul, MN 55075-1139

Toll Free: 1-800-345-3085  
Outside U.S.: 651-453-2129  
FAX: 651-450-4085  
[www.wellsfargo.com/shareownerservices](http://www.wellsfargo.com/shareownerservices)

**Online Account Access :** Registered shareowners can access account information by visiting [www.shareowneronline.com](http://www.shareowneronline.com).

**Dividend Reinvestment Plan:** Shareowners may choose to have dividends on their PPL common stock or PPL Electric preferred and preference stock reinvested in PPL common stock instead of receiving the dividend by check. Participants in PPL's Dividend Reinvestment Plan may choose to have their common stock certificates deposited into their Plan account.

**Direct Registration System:** PPL and PPL Electric participate in the Direct Registration System (DRS). Shareowners may choose to have their common or preferred stock certificates deposited into the DRS.

### **Listed Securities:**

#### **New York Stock Exchange**

**PPL Corporation:**  
Common Stock (Code: PPL)

**PPL Energy Supply, LLC:**  
7.0% Senior Unsecured Notes due 2046  
(Code: PLS)

**PPL Electric Utilities Corporation:**

4-1/2% Preferred Stock  
(Code: PPLPRB)

4.40% Series Preferred Stock  
(Code: PPLPRA)

**PPL Capital Funding, Inc.:**

2007 Series A Junior Subordinated Notes due 2067  
(Code: PPL/67)

6.85% Senior Notes due 2047  
(Code: PLV)

**Fiscal Agents:**

**Stock Transfer Agent and Registrar;  
Dividend Reinvestment Plan Agent**

Wells Fargo Bank, N.A.  
Shareowner Services  
161 North Concord Exchange  
South St. Paul, MN 55075-1139

Toll Free: 1-800-345-3085  
Outside U.S.: 651-453-2129

**Dividend Disbursing Office**

PPL Investor Services  
Two North Ninth Street (GENTW13)  
Allentown, PA 18101

FAX: 610-774-5106  
Via email: [invserv@pplweb.com](mailto:invserv@pplweb.com)

Or call the PPL Shareowner Information Line  
Toll Free: 1-800-345-3085

**Mortgage Bond Trustee  
Transfer and Bond Interest Paying Agent**

Deutsche Bank Trust Company Americas  
648 Grassmere Park Road  
Nashville, TN 37211

Toll Free: 1-800-735-7777  
FAX: 615-835-2727

**Indenture Trustee**

The Bank of New York Mellon  
101 Barclay Street  
New York, NY 10286

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**PPL Corporation**  
(Registrant)

By /s/ James H. Miller  
James H. Miller -  
Chairman, President and  
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the date indicated.

TITLE

By /s/ James H. Miller  
James H. Miller -  
Chairman, President and  
Chief Executive Officer

Principal Executive Officer and Director

By /s/ Paul A. Farr  
Paul A. Farr -  
Executive Vice President and  
Chief Financial Officer

Principal Financial Officer

By /s/ J. Matt Simmons, Jr.  
J. Matt Simmons, Jr. -  
Vice President and Controller

Principal Accounting Officer

Directors:

Frederick M. Bernthal  
John W. Conway  
E. Allen Deaver  
Louise K. Goeser  
Stuart E. Graham

Stuart Heydt  
Craig A. Rogerson  
W. Keith Smith  
Natica von Althann  
Keith H. Williamson

By /s/ James H. Miller  
James H. Miller, Attorney-in-fact

Date: February 25, 2010

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PPL Energy Supply, LLC  
(Registrant)

By /s/ James H. Miller  
James H. Miller -  
President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the date indicated.

TITLE

By /s/ James H. Miller  
James H. Miller -  
President

Principal Executive Officer and Manager

By /s/ Paul A. Farr  
Paul A. Farr -  
Executive Vice President

Principal Financial Officer and Manager

By /s/ J. Matt Simmons, Jr.  
J. Matt Simmons, Jr. -  
Vice President and Controller

Principal Accounting Officer

Managers:

/s/ Robert J. Grey  
Robert J. Grey

/s/ William H. Spence  
William H. Spence

/s/ James E. Abel  
James E. Abel

Date: February 25, 2010

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**PPL Electric Utilities Corporation**  
(Registrant)

By /s/ David G. DeCampli  
David G. DeCampli -  
President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the date indicated.

TITLE

By /s/ David G. DeCampli  
David G. DeCampli -  
President

Principal Executive Officer and Director

By /s/ J. Matt Simmons, Jr.  
J. Matt Simmons, Jr. -  
Vice President and Controller

Principal Financial Officer and  
Principal Accounting Officer

Directors:

/s/ James H. Miller  
James H. Miller

/s/ William H. Spence  
William H. Spence

/s/ Paul A. Farr  
Paul A. Farr

/s/ Dean A. Christiansen  
Dean A. Christiansen

/s/ Robert J. Grey  
Robert J. Grey

Date: February 25, 2010

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## EXHIBIT INDEX

The following Exhibits indicated by an asterisk preceding the Exhibit number are filed herewith. The balance of the Exhibits have heretofore been filed with the Commission and pursuant to Rule 12(b)-32 are incorporated herein by reference. Exhibits indicated by a [ ] are filed or listed pursuant to Item 601(b)(10)(iii) of Regulation S-K.

- 3(a) - Amended and Restated Articles of Incorporation of PPL Corporation effective May 21, 2008 (Exhibit 3(i) to PPL Corporation Form 8-K Report (File No. 1-11459) dated May 21, 2008)
- 3(b) - Amended and Restated Articles of Incorporation of PPL Electric Utilities Corporation (Exhibit 3(a) to PPL Electric Utilities Corporation Form 10-Q Report (File No. 1-905) for the quarter ended March 31, 2006)
- 3(c) - Certificate of Formation of PPL Energy Supply, LLC (Exhibit 3.1 to PPL Energy Supply, LLC Form S-4 (Registration Statement No. 333-74794))
- 3(d) - Amended and Restated Bylaws of PPL Corporation, effective May 21, 2008 (Exhibit 3.(ii) to PPL Corporation Form 8-K Report (File No. 1-11459) dated May 21, 2008)
- 3(e) - Bylaws of PPL Electric Utilities Corporation, as amended and restated effective March 30, 2006 (Exhibit 3.2 to PPL Electric Utilities Corporation Form 8-K Report (File No. 1-905) dated March 30, 2006)
- 3(f) - Limited Liability Company Agreement of PPL Energy Supply, LLC, dated March 20, 2001 (Exhibit 3.2 to PPL Energy Supply, LLC Form S-4 (Registration Statement No. 333-74794))
- 4(a)-1 - Amended and Restated Employee Stock Ownership Plan, dated January 12, 2007 (Exhibit 4(a) to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2006)
- 4(a)-2 - Amendment No. 1 to said Amended and Restated Employee Stock Ownership Plan, dated July 2, 2007 (Exhibit 4(a) to PPL Corporation Form 10-Q Report (File No. 1-11459) for the quarter ended September 30, 2007)
- 4(a)-3 - Amendment No. 2 to said Amended and Restated Employee Stock Ownership Plan, dated December 13, 2007 (Exhibit 4(a)-3 to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2007)
- 4(a)-4 - Amendment No. 3 to said Amended and Restated Employee Stock Ownership Plan, dated August 19, 2009 (Exhibit 4(a) to PPL Corporation Form 10-Q Report (File No. 1-11459) for quarter ended September 30, 2009)
- \*4(a)-5 - Amendment No. 4 to said Amended and Restated Employee Stock Ownership Plan, dated December 2, 2009
- 4(b) - Trust Deed constituting £150 million 9 ¼ percent Bonds due 2020, dated November 9, 1995, between South Wales Electric plc and Bankers Trustee Company Limited (Exhibit 4(k) to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2004)
- 4(c)-1 - Indenture, dated as of November 1, 1997, among PPL Corporation, PPL Capital Funding, Inc. and JPMorgan Chase Bank (formerly The Chase Manhattan Bank), as Trustee (Exhibit 4.1 to PPL Corporation Form 8-K Report (File No. 1-11459) dated November 12, 1997)
- 4(c)-2 - Supplement, dated as of May 18, 2004, to said Indenture (Exhibit 4.7 to Registration Statement Nos. 333-116478, 333-116478-01 and 333-116478-02)
- 4(c)-3 - Supplement, dated as of July 1, 2007, to said Indenture (Exhibit 4(b) to PPL Corporation Form 8-K Report (File No. 1-11459) dated July 16, 2007)
- 4(d)-1 - Indenture, dated as of August 1, 2001, by PPL Electric Utilities Corporation and JPMorgan Chase Bank (formerly The Chase Manhattan Bank), as Trustee (Exhibit 4.1 to PPL Electric Utilities Corporation Form 8-K Report (File No. 1-905) dated August 21, 2001)
- 4(d)-2 - Supplement, dated as of February 1, 2005, to said Indenture (Exhibit 4(g)-5 to PPL Electric Utilities Corporation Form 10-K Report (File No. 1-905) for the year ended December 31, 2004)
- 4(d)-3 - Supplement, dated as of May 1, 2005, to said Indenture (Exhibit 4(b) to PPL Electric Utilities Corporation Form 10-Q Report (File No. 1-905) for the quarter ended June 30, 2005)
- 4(d)-4 - Supplement, dated as of December 1, 2005, to said Indenture (Exhibit 4(a) to PPL Electric Utilities Corporation Form 8-K Report (File No. 1-905) dated December 22, 2005)
- 4(d)-5 - Supplement, dated as of August 1, 2007, to said Indenture (Exhibit 4(b) to PPL Electric Utilities Corporation Form 8-K Report (File No. 1-905) dated August 14, 2007)

- 4(d)-6 - Supplement, dated as of October 1, 2008, to said Indenture (Exhibit 4(b) to PPL Electric Utilities Corporation Form 8-K Report (File No. 1-905) dated October 20, 2008)
- 4(d)-7 - Supplement, dated as of October 1, 2008, to said Indenture (Exhibit 4(c) to PPL Electric Utilities Corporation Form 8-K Report (File No. 1-905) dated October 31, 2008)
- 4(d)-8 - Supplement, dated as of May 1, 2009, to said Indenture (Exhibit 4(b) to PPL Electric Utilities Corporation Form 8-K Report (File No. 1-905) dated May 22, 2009)
- 4(e)-1 - Indenture, dated as of October 1, 2001, by PPL Energy Supply, LLC and JPMorgan Chase Bank (formerly The Chase Manhattan Bank), as Trustee (Exhibit 4.1 to PPL Energy Supply, LLC Form S-4 (Registration Statement No. 333-74794))
- 4(e)-2 - Supplement, dated as of October 1, 2001, to said Indenture (Exhibit 4.2 to PPL Energy Supply, LLC Form S-4 (Registration Statement No. 333-74794))
- 4(e)-3 - Registration Rights Agreement, dated October 19, 2001, between PPL Energy Supply, LLC and the Initial Purchasers (Exhibit 4.5 to PPL Energy Supply, LLC Form S-4 (Registration Statement No. 333-74794))
- 4(e)-4 - Supplement, dated as of August 15, 2004, to said Indenture (Exhibit 4(h)-4 to PPL Energy Supply, LLC Form 10-K Report (File No. 333-74794) for the year ended December 31, 2004)
- 4(e)-5 - Supplement, dated as of October 15, 2005, to said Indenture (Exhibit 4(a) to PPL Energy Supply, LLC Form 8-K Report (File No. 333-74794) dated October 28, 2005)
- 4(e)-6 - Form of Note for PPL Energy Supply, LLC's \$300 million aggregate principal amount of 5.70% REset Put Securities due 2035 (REPS<sup>SM</sup>) (Exhibit 4(b) to PPL Energy Supply, LLC Form 8-K Report (File No. 333-74794) dated October 28, 2005)
- 4(e)-7 - Supplement, dated as of May 1, 2006, to said Indenture (Exhibit 4(a) to PPL Energy Supply, LLC Form 10-Q Report (File No. 333-74794) for the quarter ended June 30, 2006)
- 4(e)-8 - Supplement, dated as of July 1, 2006, to said Indenture (Exhibit 4(b) to PPL Energy Supply, LLC Form 10-Q Report (File No. 333-74794) for the quarter ended June 30, 2006)
- 4(e)-9 - Supplement, dated as of July 1, 2006, to said Indenture (Exhibit 4(c) to PPL Energy Supply, LLC Form 10-Q Report (File No. 333-74794) for the quarter ended June 30, 2006)
- 4(e)-10 - Supplement, dated as of December 1, 2006, to said Indenture (Exhibit 4(f)-10 to PPL Energy Supply, LLC Form 10-K Report (File No. 333-74794) for the year ended December 31, 2006)
- 4(e)-11 - Supplement, dated as of December 1, 2007, to said Indenture (Exhibit 4(b) to PPL Energy Supply, LLC Form 8-K Report (File No. 333-74794) dated December 18, 2007)
- 4(e)-12 - Supplement, dated as of March 1, 2008, to said Indenture (Exhibit 4(b) to PPL Energy Supply, LLC Form 8-K Report (File No. 333-74794) dated March 14, 2008)
- 4(e)-13 - Supplement, dated as of July 1, 2008, to said Indenture (Exhibit 4(b) to PPL Energy Supply, LLC Form 8-K Report (File No. 1-32944) dated July 21, 2008)
- 4(f)-1 - Trust Deed constituting £200 million 5.875 percent Bonds due 2027, dated March 25, 2003, between Western Power Distribution (South West) plc and J.P. Morgan Corporate Trustee Services Limited (Exhibit 4(o)-1 to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2004)
- 4(f)-2 - Supplement, dated May 27, 2003, to said Trust Deed, constituting £50 million 5.875 percent Bonds due 2027 (Exhibit 4(o)-2 to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2004)
- \*4(g) - Indenture, dated as of March 16, 2001, among WPD Holdings UK, Bankers Trust Company, as Trustee, Principal Paying Agent, and Transfer Agent and Deutsche Bank Luxembourg, S.A., as Paying and Transfer Agent
- 4(h) - Trust Deed constituting £105 million 1.541 percent Index-Linked Notes due 2053, dated December 1, 2006, between Western Power Distribution (South West) plc and HSBC Trustee (CI) Limited (Exhibit 4(i) to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2006)
- i) - Trust Deed constituting £120 million 1.541 percent Index-Linked Notes due 2056, dated December 1, 2006, between Western Power Distribution (South West) plc and HSBC Trustee (CI) Limited (Exhibit 4(j) to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2006)



- 4(j) - Trust Deed constituting £225 million 4.80436 percent Notes due 2037, dated December 21, 2006, between Western Power Distribution (South Wales) plc and HSBC Trustee (CI) Limited (Exhibit 4(k) to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2006)
- 4(k)-1 - Subordinated Indenture, dated as of March 1, 2007, between PPL Capital Funding, Inc., PPL Corporation and The Bank of New York, as Trustee (Exhibit 4(a) to PPL Corporation Form 8-K Report (File No. 1-11459) dated March 20, 2007)
- 4(k)-2 - Supplement, dated as of March 1, 2007, to said Subordinated Indenture (Exhibit 4(b) to PPL Corporation Form 8-K Report (File No. 1-11459) dated March 20, 2007)
- 4(l)-1 - Series 2009A Exempt Facilities Loan Agreement, dated as of April 1, 2009, between PPL Energy Supply, LLC and Pennsylvania Economic Development Financing Authority (Exhibit 4(a) to PPL Energy Supply, LLC Form 8-K Report (File No. 1-32944) dated April 9, 2009)
- 4(l)-2 - Series 2009B Exempt Facilities Loan Agreement, dated as of April 1, 2009, between PPL Energy Supply, LLC and Pennsylvania Economic Development Financing Authority (Exhibit 4(b) to PPL Energy Supply, LLC Form 8-K Report (File No. 1-32944) dated April 9, 2009)
- 4(l)-3 - Series 2009C Exempt Facilities Loan Agreement, dated as of April 1, 2009, between PPL Energy Supply, LLC and Pennsylvania Economic Development Financing Authority (Exhibit 4(c) to PPL Energy Supply, LLC Form 8-K Report (File No. 1-32944) dated April 9, 2009)
- 10(a) - \$150 Million Credit and Reimbursement Agreement, dated as of April 25, 2001, among PPL Montana, LLC and the banks named therein (Exhibit 10(d) to PPL Montana, LLC Form 10-Q Report (File No. 333-50350) for the quarter ended June 30, 2001)
- 10(b) - Generation Supply Agreement, dated as of June 20, 2001, between PPL Electric Utilities Corporation and PPL EnergyPlus, LLC (Exhibit 10.5 to PPL Energy Supply, LLC Form S-4 (Registration Statement No. 333-74794))
- 10(c)-1 - Master Power Purchase and Sale Agreement, dated as of October 15, 2001, between NorthWestern Energy Division (successor in interest to The Montana Power Company) and PPL Montana, LLC (Exhibit 10(g) to PPL Montana, LLC Form 10-K Report (File No. 333-50350) for the year ended December 31, 2001)
- 10(c)-2 - Confirmation Letter dated July 5, 2006, between PPL Montana, LLC and NorthWestern Corporation (PPL Corporation and PPL Energy Supply, LLC Form 8-K Reports (File Nos. 1-11459 and 333-74794) dated July 6, 2006)
- 10(d) - Guaranty, dated as of December 21, 2001, from PPL Energy Supply, LLC in favor of LMB Funding, Limited Partnership (Exhibit 10(j) to PPL Energy Supply, LLC Form 10-K Report (File No. 333-74794) for the year ended December 31, 2001)
- 10(e)-1 - Agreement for Lease, dated as of December 21, 2001, between LMB Funding, Limited Partnership and Lower Mt. Bethel Energy, LLC (Exhibit 10(m) to PPL Energy Supply, LLC Form 10-K Report (File No. 333-74794) for the year ended December 31, 2003)
- 10(e)-2 - Amendment No. 1 to Agreement for Lease, dated as of September 16, 2002, between LMB Funding, Limited Partnership and Lower Mt. Bethel Energy, LLC (Exhibit 10(m)-1 to PPL Energy Supply, LLC Form 10-K Report (File No. 333-74794) for the year ended December 31, 2003)
- 10(f)-1 - Lease Agreement, dated as of December 21, 2001, between LMB Funding, Limited Partnership and Lower Mt. Bethel Energy, LLC (Exhibit 10(n) to PPL Energy Supply, LLC Form 10-K Report (File No. 333-74794) for the year ended December 31, 2003)
- 10(f)-2 - Amendment No. 1 to Lease Agreement, dated as of September 16, 2002, between LMB Funding, Limited Partnership and Lower Mt. Bethel Energy, LLC (Exhibit 10(n)-1 to PPL Energy Supply, LLC Form 10-K Report (File No. 333-74794) for the year ended December 31, 2003)
- 10(g) - Pollution Control Facilities Loan Agreement, dated as of May 1, 1973, between PPL Electric Utilities Corporation and the Lehigh County Industrial Development Authority (Exhibit 5(z) to Registration Statement No. 2-60834)
- 10(h) - Facility Lease Agreement (BA 1/2) between PPL Montana, LLC and Montana OL3, LLC (Exhibit 4.7a to PPL Montana, LLC Form S-4 (Registration Statement No. 333-50350))
- 10(i) - Facility Lease Agreement (BA 3) between PPL Montana, LLC and Montana OL4, LLC (Exhibit 4.8a to PPL Montana, LLC Form S-4 (Registration Statement No. 333-50350))
- 10(j) - Services Agreement, dated as of July 1, 2000, among PPL Corporation, PPL Energy Funding Corporation and its direct and indirect subsidiaries in various tiers, PPL Capital Funding, Inc., PPL Gas Utilities Corporation, PPL Services Corporation and CEP Commerce, LLC (Exhibit 10.20 to PPL Energy Supply, LLC Form S-4 (Registration Statement

No. 333-74794))

- 10(k)-1 - Asset Purchase Agreement, dated as of June 1, 2004, by and between PPL Sundance Energy, LLC, as Seller, and Arizona Public Service Company, as Purchaser (Exhibit 10(a) to PPL Corporation and PPL Energy Supply, LLC Form 10-Q Reports (File Nos. 1-11459 and 333-74794) for the quarter ended June 30, 2004)
- 10(k)-2 - Amendment No. 1, dated December 14, 2004, to said Asset Purchase Agreement (Exhibit 99.1 to PPL Corporation and PPL Energy Supply, LLC Form 8-K Reports (File Nos. 1-11459 and 333-74794) dated December 15, 2004)
- 10(l)-1 - Receivables Sale Agreement, dated as of August 1, 2004, between PPL Electric Utilities Corporation, as Originator, and PPL Receivables Corporation, as Buyer (Exhibit 10(d) to PPL Electric Utilities Corporation Form 10-Q Report (File No. 1-905) for the quarter ended June 30, 2004)
- 10(l)-2 - Amendment No. 1 to Receivables Sale Agreement, dated as of August 5, 2008, between PPL Electric Utilities Corporation, as Originator, and PPL Receivables Corporation, as Buyer (Exhibit 10(b) to PPL Electric Utilities Corporation Form 8-K Report (File No. 1-905) dated August 6, 2008)
- 10(l)-3 - Credit and Security Agreement, dated as of August 5, 2008, among PPL Receivables Corporation, PPL Electric Utilities Corporation, Victory Receivables Corporation, the Liquidity Banks from time to time party thereto and The Bank of Tokyo-Mitsubishi UFJ, Ltd., New York Branch (Exhibit 10(a) to PPL Electric Utilities Corporation Form 8-K Report (File No. 1-905) dated August 6, 2008)
- 10(l)-4 - Amendment No. 1 to said Credit and Security Agreement, dated as of July 28, 2009, among PPL Receivables Corporation, as Borrower, PPL Electric Utilities Corporation, as Servicer, Victory Receivables Corporation, as a Lender, and The Bank of Tokyo-Mitsubishi UFJ, Ltd, New York Branch, as Liquidity Bank and as Agent (Exhibit 10(a) to PPL Electric Utilities Corporation Form 10-Q Report (File No. 1-905) for quarter ended September 30, 2009)
- 10(l)-5 - Amended and Restated Fee Letter, dated July 28, 2009, among PPL Receivables Corporation, as Borrower, PPL Electric Utilities Corporation, as Servicer, Victory Receivables Corporation, as a Lender, and The Bank of Tokyo-Mitsubishi UFJ, Ltd, New York Branch, as Liquidity Bank and as Agent (Exhibit 10(b) to PPL Electric Utilities Corporation Form 10-Q Report (File No. 1-905) for quarter ended September 30, 2009)
- 10(m) - \$300 Million Demand Loan Agreement, dated as of August 20, 2004, among CEP Lending, Inc. and PPL Energy Funding Corporation (Exhibit 10(dd) to PPL Electric Utilities Corporation Form 10-K Report (File No. 1-905) for the year ended December 31, 2004)
- 10(n)-1 - Reimbursement Agreement, dated as of March 31, 2005, among PPL Energy Supply, LLC, The Bank of Nova Scotia, as Issuer and Administrative Agent, and the Lenders party thereto from time to time (Exhibit 10(a) to PPL Energy Supply, LLC Form 10-Q Report (File No. 333-74794) for the quarter ended March 31, 2005)
- 10(n)-2 - First Amendment to said Reimbursement Agreement, dated as of June 16, 2005 (Exhibit 10(b) to PPL Energy Supply, LLC Form 10-Q Report (File No. 333-74794) for the quarter ended June 30, 2005)
- 10(n)-3 - Second Amendment to said Reimbursement Agreement, dated as of September 1, 2005 (Exhibit 10(a) to PPL Energy Supply, LLC Form 10-Q Report (File No. 333-74794) for the quarter ended September 30, 2005)
- 10(n)-4 - Third Amendment to said Reimbursement Agreement, dated as of March 30, 2006 (Exhibit 10(a) to PPL Energy Supply, LLC Form 8-K Report (File No. 333-74794) dated April 5, 2006)
- 10(n)-5 - Fourth Amendment to said Reimbursement Agreement, dated as of April 12, 2006 (Exhibit 10(b) to PPL Energy Supply, LLC Form 10-Q Report (File No. 333-74794) for the quarter ended September 30, 2006)
- 10(n)-6 - Fifth Amendment to said Reimbursement Agreement, dated as of November 1, 2006 (Exhibit 10(q)-6 to PPL Energy Supply, LLC Form 10-K Report (File No. 333-74794) for the year ended December 31, 2006)
- 10(n)-7 - Sixth Amendment to said Reimbursement Agreement, dated as of March 29, 2007 (Exhibit 10(q)-7 to PPL Energy Supply, LLC Form 10-K Report (File No. 333-74794) for the year ended December 31, 2007)
- 10(n)-8 - Seventh Amendment to said Reimbursement Agreement, dated as of March 1, 2008 (Exhibit 10(a) to PPL Energy Supply, LLC Form 10-Q Report (File No. 333-74794) for the quarter ended March 31, 2008)
- 10(n)-9 - Eighth Amendment to said Reimbursement Agreement, dated as of March 30, 2009 (Exhibit 10(a) to PPL Energy Supply, LLC Form 10-Q Report (File No. 1-32944) for the quarter ended March 31, 2009)
- 10(o)-1 - \$300 Million Five-Year Letter of Credit and Revolving Credit Agreement, dated as of December 15, 2005, among PPL Energy Supply, LLC and the banks named therein (Exhibit 10(b) to PPL Energy Supply, LLC Form 8-K Report (File No. 333-74794) dated December 21, 2005)

- 10(o)-2 - First Amendment to said Letter of Credit and Revolving Credit Agreement, dated as of December 29, 2006 (Exhibit 10(t)-2 to PPL Energy Supply, LLC Form 10-K Report (File No. 333-74794) for the year ended December 31, 2006)
- 10(p)-1 - \$300 Million Five-Year Letter of Credit and Reimbursement Agreement, dated as of December 15, 2005, among PPL Energy Supply and the banks named therein (Exhibit 10(c) to PPL Energy Supply, LLC Form 8-K Report (File No. 333-74794) dated December 21, 2005)
- 10(p)-2 - First Amendment to said Letter of Credit and Reimbursement Agreement, dated as of December 29, 2006 (Exhibit 10(u)-2 to PPL Energy Supply, LLC Form 10-K Report (File No. 333-74794) for the year ended December 31, 2006)
- 10(q) - \$400 million Amended and Restated 364-Day Credit Agreement, dated as of September 8, 2009, among PPL Energy Supply, LLC and the banks named therein (Exhibit 10(a) to PPL Energy Supply, LLC Form 8-K Report (File No. 1-32944) dated September 11, 2009)
- 10(r)-1 - \$200 million Third Amended and Restated Five-Year Credit Agreement, dated as of May 4, 2007, among PPL Electric Utilities Corporation and the banks named therein (Exhibit 10(b) to PPL Electric Utilities Corporation Form 8-K Report (File No. 1-905) dated May 9, 2007)
- 10(r)-2 - First Amendment to Third Amended and Restated Credit Agreement, dated as of December 3, 2008, by and among PPL Electric Utilities Corporation, certain of the lenders party to the Third Amended and Restated Credit Agreement dated as of May 4, 2007 and Wachovia Bank, National Association, as administrative agent (Exhibit 99.2 to PPL Electric Utilities Corporation Form 8-K Report (File No. 1-905) December 4, 2008)
- 10(s)-1 - \$3.4 billion Second Amended and Restated Five-Year Credit Agreement, dated as of May 4, 2007, among PPL Energy Supply, LLC and the banks named therein (Exhibit 10(a) to PPL Energy Supply, LLC Form 8-K Report (File No. 333-74794) dated May 9, 2007)
- 10(s)-2 - First Amendment to Second Amended and Restated Credit Agreement, dated as of December 3, 2008, by and among PPL Energy Supply, LLC, certain of the lenders party to the Second Amended and Restated Credit Agreement dated as of May 4, 2007 and Wachovia Bank, National Association, as administrative agent (Exhibit 99.1 to PPL Energy Supply, LLC Form 8-K Report (File No. 1-32944) dated December 4, 2008)
- 10(t) - £150 million Credit Agreement, dated as of January 24, 2007, among Western Power Distribution Holdings Limited and the banks named therein (Exhibit 10(y) to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2006)
- 10(u)-1 - Pollution Control Facilities Loan Agreement, dated as of February 1, 2005, between PPL Electric Utilities Corporation and the Lehigh County Industrial Development Authority (Exhibit 10(ff) to PPL Electric Utilities Corporation Form 10-K Report (File No. 1-905) for the year ended December 31, 2004)
- 10(u)-2 - Pollution Control Facilities Loan Agreement, dated as of May 1, 2005, between PPL Electric Utilities Corporation and the Lehigh County Industrial Development Authority (Exhibit 10(a) to PPL Electric Utilities Corporation Form 10-Q Report (File No. 1-905) for the quarter ended June 30, 2005)
- 10(u)-3 - Pollution Control Facilities Loan Agreement, dated as of October 1, 2008, between Pennsylvania Economic Development Financing Authority and PPL Electric Utilities Corporation (Exhibit 4(a) to PPL Electric Utilities Corporation Form 8-K Report (File No. 1-905) dated October 31, 2008)
- 10(v) - £210 million Multicurrency Revolving Facility Agreement, dated July 7, 2009, between Western Power Distribution (South West) plc and HSBC Bank plc, Lloyds TSB Bank plc and Clydesdale Bank plc (Exhibit 10(c) to PPL Corporation Form 10-Q Report (File No. 1-11459) for quarter ended June 30, 2009)
- 10(w)-1 - Amended and Restated Directors Deferred Compensation Plan, dated June 12, 2000 (Exhibit 10(h) to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2000)
- 10(w)-2 - Amendment No. 1 to said Amended and Restated Directors Deferred Compensation Plan, dated December 18, 2002 (Exhibit 10(m)-1 to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2002)
- 10(w)-3 - Amendment No. 2 to said Amended and Restated Directors Deferred Compensation Plan, dated December 4, 2003 (Exhibit 10(q)-2 to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2003)
- 10(w)-4 - Amendment No. 3 to said Amended and Restated Directors Deferred Compensation Plan, dated as of January 1, 2005 (Exhibit 10(cc)-4 to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2005)
- 10(w)-5 - Amendment No. 4 to said Amended and Restated Directors Deferred Compensation Plan, dated as of May 1, 2008 (Exhibit 10(x)-5 to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2008)
- 10(x)-1 - Trust Agreement, dated as of April 1, 2001, between PPL Corporation and Wachovia Bank, N.A. (as successor to First

Union National Bank), as Trustee

- 10(x)-2 - Trust Agreement, dated as of March 20, 2007, between PPL Corporation and Wachovia Bank, N.A., as Trustee (Exhibit 10(c) to PPL Corporation Form 10-Q Report (File No. 1-1149) for the quarter ended March 31, 2007)
- 10(x)-3 - Trust Agreement, dated as of March 20, 2007, between PPL Corporation and Wachovia Bank, N.A., as Trustee (Exhibit 10(d) to PPL Corporation Form 10-Q Report (File No. 1-11459) for the quarter ended March 31, 2007)
- 10(x)-4 - Trust Agreement, dated as of March 20, 2007, between PPL Corporation and Wachovia Bank, N.A., as Trustee (Exhibit 10(e) to PPL Corporation Form 10-Q Report (File No. 1-11459) for the quarter ended March 31, 2007)
- 10(y)-1 - Amended and Restated Officers Deferred Compensation Plan, dated December 8, 2003 (Exhibit 10(r) to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2003)
- 10(y)-2 - Amendment No. 1 to said Amended and Restated Officers Deferred Compensation Plan, dated as of January 1, 2005 (Exhibit 10(ee)-1 to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2005)
- 10(y)-3 - Amendment No. 2 to said Amended and Restated Officers Deferred Compensation Plan, dated as of January 22, 2007 (Exhibit 10(bb)-3 to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2006)
- 10(y)-4 - Amendment No. 3 to said Amended and Restated Officers Deferred Compensation Plan, dated as of June 1, 2008 (Exhibit 10(z)-4 to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2008)
- 10(z)-1 - Amended and Restated Supplemental Executive Retirement Plan, dated December 8, 2003 (Exhibit 10(s) to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2003)
- 10(z)-2 - Amendment No. 1 to said Supplemental Executive Retirement Plan, dated December 16, 2004 (Exhibit 99.1 to PPL Corporation Form 8-K Report (File No. 1-11459) dated December 17, 2004)
- 10(z)-3 - Amendment No. 2 to said Supplemental Executive Retirement Plan, dated as of January 1, 2005 (Exhibit 10(ff)-3 to PPL Corporation Form 10-K Report (File 1-11459) for the year ended December 31, 2005)
- 10(z)-4 - Amendment No. 3 to said Supplemental Executive Retirement Plan, dated as of January 22, 2007 (Exhibit 10(cc)-4 to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2006)
- 10(z)-5 - Amendment No. 4 to said Supplement Executive Retirement Plan, dated as of December 9, 2008 (Exhibit 10(aa)-5 to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2008)
- 10(aa)-1 - Incentive Compensation Plan, amended and restated effective January 1, 2003 (Exhibit 10(p) to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2002)
- 10(aa)-2 - Amendment No. 1 to said Incentive Compensation Plan, dated as of January 1, 2005 (Exhibit 10(gg)-2 to PPL Corporation Form 10-K Report (File 1-11459) for the year ended December 31, 2005)
- 10(aa)-3 - Amendment No. 2 to said Incentive Compensation Plan, dated as of January 26, 2007 (Exhibit 10(dd)-3 to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2006)
- 10(aa)-4 - Amendment No. 3 to said Incentive Compensation Plan, dated as of March 21, 2007 (Exhibit 10(f) to PPL Corporation Form 10-Q Report (File No. 1-11459) for the quarter ended March 31, 2007)
- 10(aa)-5 - Amendment No. 4 to said Incentive Compensation Plan, effective December 1, 2007 (Exhibit 10(a) to PPL Corporation Form 10-Q Report (File No. 1-11459) for the quarter ended September, 30, 2008)
- 10(aa)-6 - Amendment No. 5 to said Incentive Compensation Plan, dated as of December 16, 2008 (Exhibit 10(bb)-6 to PPL Corporation Form 10-K Report (File 1-11459) for the year ended December 31, 2008)
- 10(aa)-7 - Form of Stock Option Agreement for stock option awards under the Incentive Compensation Plan (Exhibit 10(a) to PPL Corporation Form 8-K Report (File No. 1-11459) dated February 1, 2006)
- 10(aa)-8 - Form of Restricted Stock Unit Agreement for restricted stock unit awards under the Incentive Compensation Plan (Exhibit 10(b) to PPL Corporation Form 8-K Report (File No. 1-11459) dated February 1, 2006)
- 10(aa)-9 - Form of Restricted Stock Unit Agreement for restricted stock unit awards under the Incentive Compensation Plan pursuant to PPL Corporation Cash Incentive Premium Exchange Program (Exhibit 10(c) to PPL Corporation Form 8-K Report (File No. 1-11459) dated February 1, 2006)
- 10(bb)-1 - Incentive Compensation Plan for Key Employees, amended and restated effective January 1, 2003 (Schedule B to Proxy Statement of PPL Corporation, dated March 17, 2003)

- 10(bb)-2 - Amendment No. 1 to said Incentive Compensation Plan for Key Employees, dated as of January 1, 2005 (Exhibit (hh)-1 to PPL Corporation Form 10-K Report (File 1-11459) for the year ended December 31, 2005
- 10(bb)-3 - Amendment No. 2 to said Incentive Compensation Plan for Key Employees, dated as of January 26, 2007 (Exhibit 10 (ee)-3 to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2006)
- 10(bb)-4 - Amendment No. 3 to said Incentive Compensation Plan for Key Employees, dated as of March 21, 2007 (Exhibit 10(q) to PPL Corporation Form 10-Q Report (File No. 1-11459) for the quarter ended March 31, 2007)
- 10(bb)-5 - Amendment No. 4 to said Incentive Compensation Plan for Key Employees, dated as of December 15, 2008 (Exhibit 10 (cc)-5 to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2008)
- 10(cc) - Short-term Incentive Plan (Schedule A to Proxy Statement of PPL Corporation, dated March 20, 2006)
- 10(dd) - Agreement dated January 15, 2003 between PPL Corporation and Mr. Miller regarding Supplemental Pension Benefits (Exhibit 10(u) to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2002)
- 10(ee) - Employment letter dated December 19, 2005 between PPL Services Corporation and Jerry Matthews Simmons, Jr. (Exhibit 10(jj) to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2006)
- 10(ff) - Employment letter dated May 31, 2006 between PPL Services Corporation and William H. Spence (Exhibit 10(pp) to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2006)
- 10(gg) - Employment letter dated August 29, 2006, between PPL Services Corporation and David G. DeCampi (Exhibit 10(qq) to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2006)
- 10(hh) - Amendments to certain compensation programs and arrangements for Named Executive Officers of PPL Corporation and PPL Electric Utilities Corporation and compensation arrangement changes for non-employee Directors of PPL Corporation (PPL Corporation and PPL Electric Utilities Corporation Form 8-K Reports (File Nos. 1-11459 and 1-905) dated November 1, 2006)
- 10(ii) - Form of Retention Agreement entered into between PPL Corporation and Messrs. Champagne, Farr, Miller and Shriver (Exhibit 10(h) to PPL Corporation Form 10-Q Report (File No. 1-11459) for the quarter ended March 31, 2007)
- 10(jj)-1 - Form of Severance Agreement entered into between PPL Corporation and the Named Executive Officers (Exhibit 10(i) to PPL Corporation Form 10-Q Report (File No. 1-11459) for the quarter ended March 31, 2007)
- 10(jj)-2 - Amendment to said Severance Agreement (Exhibit 10(a) to PPL Corporation Form 10-Q Report (File No. 1-11459) for the quarter ended June 30, 2009)
- 10(kk) - Form of Performance Unit Agreement entered into between PPL Corporation and the Named Executive Officers (Exhibit 10(ss) to PPL Corporation Form 10-K Report (File No. 1-11459) for the year ended December 31, 2007)
- 10(ll) - 2009 compensation matters regarding PPL Corporation Named Executive Officers (PPL Corporation Form 8-K Report (File No. 1-11459) dated January 28, 2009)
- 10(mm) - 2009 compensation matters regarding PPL Electric Utilities Corporation Named Executive Officers (PPL Electric Utilities Corporation Form 8-K Report (File No. 1-905) dated January 28, 2009)
- 10(nn) - Establishment of 2009 annual performance goals and business criteria for incentive awards to PPL Corporation Named Executive Officers (PPL Corporation Form 8-K Report (File No. 1-11459) dated April 1, 2009)
- 10(oo) - Establishment of 2009 annual performance goals and business criteria for incentive awards to PPL Electric Utilities Corporation Named Executive Officers (PPL Electric Utilities Corporation Form 8-K Report (File No. 1-905) dated April 1, 2009)
- 10(pp) - Employment letter dated May 22, 2009, between PPL Services Corporation and Gregory W. Dudkin (Exhibit 10(b) to PPL Corporation Form 10-Q Report (File No. 1-11459) for quarter ended June 30, 2009)
- \* 12(a) - PPL Corporation and Subsidiaries Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends
- ' 2(b) - PPL Energy Supply, LLC and Subsidiaries Computation of Ratio of Earnings to Fixed Charges
- \* 12(c) - PPL Electric Utilities Corporation and Subsidiaries Computation of Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends

- \*21(a) - Subsidiaries of PPL Corporation
- \*21(b) - Subsidiaries of PPL Electric Utilities Corporation
- \*23(a) - Consent of Ernst & Young LLP - PPL Corporation
- \*23(b) - Consent of Ernst & Young LLP - PPL Energy Supply, LLC
- \*23(c) - Consent of Ernst & Young LLP - PPL Electric Utilities Corporation
- \*24 - Power of Attorney
- \*31(a) - Certificate of PPL's principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- \*31(b) - Certificate of PPL's principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- \*31(c) - Certificate of PPL Energy Supply's principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- \*31(d) - Certificate of PPL Energy Supply's principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- \*31(e) - Certificate of PPL Electric's principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- \*31(f) - Certificate of PPL Electric's principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- \*32(a) - Certificate of PPL's principal executive officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- \*32(b) - Certificate of PPL's principal financial officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- \*32(c) - Certificate of PPL Energy Supply's principal executive officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- \*32(d) - Certificate of PPL Energy Supply's principal financial officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- \*32(e) - Certificate of PPL Electric's principal executive officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- \*32(f) - Certificate of PPL Electric's principal financial officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- \*99(a) - Examples of Wholesale Energy, Fuel and Emission Allowance Price Fluctuations - 2005 through 2009
- \*\*101.INS - XBRL Instance Document for PPL Corporation
- \*\*101.SCH - XBRL Taxonomy Extension Schema for PPL Corporation
- \*\*101.CAL - XBRL Taxonomy Extension Calculation Linkbase for PPL Corporation
- \*\*101.DEF - XBRL Taxonomy Extension Definition Linkbase for PPL Corporation
- \*\*101.LAB - XBRL Taxonomy Extension Label Linkbase for PPL Corporation
- \*\*101.PRE - XBRL Taxonomy Extension Presentation Linkbase for PPL Corporation

\*\* - XBRL information will be considered to be furnished, not filed, for the first two years of a company's submission of XBRL information.

**AMENDMENT NO. 4**

**TO**

**PPL EMPLOYEE STOCK OWNERSHIP PLAN**

WHEREAS, PPL Services Corporation ("PPL") has adopted the PPL Employee Stock Ownership Plan ("Plan") effective July 1, 2000, on behalf of various affiliated companies; and

WHEREAS, the Plan was amended and restated effective January 1, 2002 and subsequently amended by Amendment No. 1, 2 and 3; and

WHEREAS, the Company desires to further amend the Plan;

NOW, THEREFORE, the Plan is hereby amended as follows:

I. Effective January 1, 2010, Section 2.20 is amended to read as follows:

2.20 **"Market Value"** shall mean, with respect to the Stock, the closing prices of the Stock reported by the New York Stock Exchange for the third trading day immediately preceding the date on which the Stock is contributed to the Plan.

II. Except as provided for in this Amendment No. 4, all other provisions of the Plan shall remain in full force and effect.

IN WITNESS WHEREOF, this Amendment No. 4 is executed this \_\_\_\_\_ day of \_\_\_\_\_, 2009.

PPL SERVICES CORPORATION

By: \_\_\_\_\_  
Stephen R. Russo  
Vice President-Human Resources  
& Services

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**WPD HOLDINGS UK**

**and**

**BANKERS TRUST COMPANY,  
as Trustee, Principal Paying Agent, and Transfer Agent**

**and**

**DEUTSCHE BANK LUXEMBOURG S.A.,  
as Paying and Transfer Agent**

**INDENTURE**

**Dated as of March 16, 2001**

**Debt Securities**

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INDENTURE, dated as of March 16, 2001, among WPD HOLDINGS UK, a private unlimited liability company duly organized and existing under the laws of England and Wales (the “*Company*”), having its principal office at Avonbank, Feeder Road, Bristol BS2 0TB, England, BANKERS TRUST COMPANY, a New York banking corporation, as trustee, principal paying agent, and transfer agent (the “*Trustee*”) and DEUTSCHE BANK LUXEMBOURG, S.A., a company organized under the laws of Luxembourg, as paying and transfer agent (the “*Paying Agent*”).

## RECITALS OF THE COMPANY

The Company has duly authorized the execution and delivery of this Indenture to provide for the issuance from time to time of certain of its unsecured debentures, notes or other evidences of indebtedness (herein called the “*Securities*”), to be issued in one or more series as provided in this Indenture.

All things necessary to make this Indenture a valid agreement of the Company, in accordance with its terms, have been done.

### NOW, THEREFORE, THIS INDENTURE WITNESSETH:

For and in consideration of the premises and the purchase of the Securities by the Holders thereof, it is mutually covenanted and agreed, for the equal and proportionate benefit of all Holders of the Securities or of series thereof, as follows:

## ARTICLE I

### DEFINITIONS AND OTHER PROVISIONS OF GENERAL APPLICATION

#### SECTION 101. Definitions

For all purposes of this Indenture, except as otherwise expressly provided or unless the context otherwise requires:

- (i) the terms defined in this Article have the respective meanings assigned to them in this Article and include the plural as well as the singular;
- (ii) all other terms used herein that are defined in the Trust Indenture Act, either directly or by reference therein, have the meanings assigned to them therein;
- (iii) all accounting terms not otherwise defined herein have the meanings assigned to them in accordance with generally accepted accounting principles in the United States and, except as otherwise herein expressly provided, the term “*generally accepted accounting principles*,” with respect to any computation required or permitted hereunder, shall mean such accounting principles as are generally accepted in the [ United Kingdom ] at the date of such computation; and
- (iv) the words “*herein*,” “*hereof*,” and “*hereunder*” and other words of similar import refer to this Indenture as a whole and not to any particular Article, Section or other subdivision.

Certain terms, used principally in Article VI, are defined in that Article.

“*Act*,” when used with respect to any Holder, has the meaning specified in Section 104.

“*Additional Amounts*” has the meaning specified in Section 1009.

“*Affiliate*” of any specified Person means any other Person, directly or indirectly, controlling or controlled by or under direct or indirect common control with such specified Person. For the purposes of this definition, “*control*,” when used with respect to any specified Person, means the power to direct the management and policies of such Person, directly or indirectly, whether through the ownership of voting securities, by contract or otherwise, and the terms “*controlling*” and “*controlled*” have meanings correlative to the foregoing.

“*Authenticating Agent*” means any Person authorized to authenticate and deliver Securities on behalf of the Trustee pursuant to Section 614.

“*Bearer Security*” means any Security that is payable to the bearer.

“*Board of Directors*” means either the board of directors of the Company or any duly authorized committee of that Board of Directors.

“*Board Resolution*” means a resolution certified by the Secretary or an Assistant Secretary of the Company (i) to have been duly adopted by the Board of Directors and (ii) to be in full force and effect on the date of such certification.

“*Book-Entry Depositary*” means, with respect to the Securities of any series issuable or issued, in whole or in part, in the form of one or more Global Securities, the Person designated as Book-Entry Depositary by the Company pursuant to Section 301, and, if so provided pursuant to Section 301 with respect to the Securities of a series, any successor to such Person. If at any time there is more than one such Person, “*Book-Entry Depositary*” shall mean, with respect to any series of Securities, the qualifying entity which has been appointed

with respect to the Securities of that series.

“*Book-Entry Interest*” means a certificateless depositary interest to be issued by the Book-Entry Depositary to DTC.

“*Business Day*,” when used with respect to the Place of Payment of the Securities of any series, means each day that is not a Saturday, a Sunday or a day on which banking institutions in any Place of Payment for the Securities of that series are authorized or obligated by law to remain closed.

“*Clearstream*” means Clearstream Banking, *société anonyme*, or its successor.

“*Commission*” means the U.S. Securities and Exchange Commission, as from time to time constituted, created under the U.S. Securities Exchange Act of 1934, as amended, or, if at any time after the execution of this instrument such commission is not existing and performing the duties now assigned to it under the Trust Indenture Act, then the body performing such duties at such time.

“*Company*” means the Person named as the “*Company*” in the first paragraph of this instrument until a successor corporation shall have become such pursuant to the applicable provisions of this Indenture, and thereafter “*Company*” shall mean such successor corporation.

“*Company Request*” or “*Company Order*” means a written request or order signed in the name of the Company by (i) any Director and (ii) any other Director, or the Treasurer, Secretary, any Assistant Treasurer or Assistant Secretary, or any other officer so authorized, and delivered to the Trustee.

“*Consolidated Net Tangible Assets*” means the total of all assets (including revaluations thereof as a result of commercial appraisals, price level restatements or otherwise) appearing on a consolidated balance sheet of the Company, net of applicable reserves and deductions, but excluding goodwill, trade names, trademarks, patents, unamortized debt discount, and all other like intangible assets (which term shall not be construed to include such revaluations), less the aggregate of the consolidated current liabilities of the Company appearing on such balance sheet.

“*Corporate Trust Office*” means the principal office of the Trustee in The City of New York, at which at any particular time its corporate trust business shall be administered, which at the date hereof is Four Albany Street, New York, New York, 10006, Attention: Manager, Project Finance, or at any other time at such address as the Trustee may designate from time to time by written notice to the Company at its principal office at Avonbank, Feeder Road, Bristol BS2 0TB, England.

“*Corporation*” includes corporations, associations, companies, and business trusts.

“*Debt*” has the meaning specified in Section 1004.

“*Default*,” for purposes of Section 601 of this Indenture, means an “*Event of Default*” as specified in Section 501 hereof, and for purposes of Section 310(b) of the Trust Indenture Act, “*default*” means an “*Event of Default*” as specified in Section 501 hereof, but exclusive of any period of grace or requirement of notice.

“*Defaulted Interest*” has the meaning specified in Section 308.

“*Deposit Agreement*” means the deposit agreement among the Company, the Book-Entry Depositary, and the holders and beneficial owners from time to time of interests in the Book-Entry Interest.

“*Director*” means any member of the Board of Directors.

“*Discharged*” means, with respect to the Securities of any series, the discharge of the entire indebtedness represented by, and obligations of the Company under, the Securities of such series and the satisfaction of all the obligations of the Company under the Indenture relating to the Securities of such series, except (i) the rights of Holders of the Securities of such series to receive, from the trust fund described in Section 403 hereof, payment of the principal of and interest and premium, if any, on the Securities of such series when such payments are due, (ii) the Company’s obligations with respect to the Securities of such series with respect to registration, transfer, exchange, and maintenance of a Place of Payment, and (iii) the rights, powers, trusts, duties, protections, and immunities of the Trustee under this Indenture.

“*Dollar*” or “*\$*” means a dollar or other equivalent unit in such coin or currency of the United States of America as at the time shall be legal tender for the payment of public and private debt.

“*DTC*” means The Depository Trust Company or its successors.

“*Euroclear*” means Euroclear Bank S.A./N.V., or its successor, as operator of the Euroclear System.

“*Event of Default*” has the meaning specified in Section 501.

“*Exchange Act*” means the Securities Exchange Act of 1934, as amended.

“*Global Security*” means a Registered or Bearer Security evidencing all or part of a series of Securities, issued to the Book-

Entry Depository for such series or its nominee.

“*Holder*” means, in the case of a Registered Security, the Person in whose name a Security is registered in the Security Register and, in the case of a Global Bearer Security, the Book-Entry Depository therefor.

“*Indenture*” means this instrument as originally executed or as it may, from time to time, be supplemented or amended by one or more indentures supplemental hereto entered into pursuant to the applicable provisions hereof, and shall include the terms of particular series of Securities established as contemplated by Section 301.

“*Indirect Participant*” means a Person that holds an interest in a Book-Entry Interest through a Person that has an account with DTC.

“*Interest*,” when used with respect to an Original Issue Discount Security that by its terms bears interest only after Maturity, means interest payable after Maturity at the rate prescribed in such Original Issue Discount Security.

“*Interest Payment Date*,” when used with respect to any Security, means the Stated Maturity of an installment of interest on such Security.

“*Letter of Representations*” means, with respect to the Securities of any series, the representation from the Company and the Trustee to DTC with respect to the Securities of that series.

“*Lien*” means any mortgage, lien, pledge, security interest or other encumbrance; *provided, however*, that the term “*Lien*” shall not mean any easements, rights-of-way, restrictions, and other similar encumbrances, and encumbrances consisting of zoning restrictions, leases, subleases, licenses, sublicenses, restrictions on the use of property or defects in title thereto.

“*Maturity*,” when used with respect to any Security, means the date on which the principal of such Security or an installment of principal becomes due and payable as therein or herein provided, whether at the Stated Maturity or by declaration of acceleration, call for redemption or otherwise.

“*Officers’ Certificate*” means a certificate signed by (i) any Director and (ii) any other Director, or the Treasurer, Secretary, any Assistant Treasurer or Assistant Secretary, or any other officer so authorized, and delivered to the Trustee.

“*Opinion of Counsel*” means a written opinion of counsel, who, unless otherwise required by the Trust Indenture Act, may be an employee of or regular counsel for the Company, or may be other counsel reasonably acceptable to the Trustee.

“*Original Issue Discount Security*” means any Security which provides for an amount less than the principal amount thereof to be due and payable upon a declaration of acceleration of the Maturity thereof pursuant to Section 502.

“*Outstanding*,” when used with respect to Securities, means, as of the date of determination, all Securities theretofore authenticated and delivered under this Indenture, except:

- (i) Securities theretofore canceled by the Trustee or delivered to the Trustee for cancellation;
- (ii) Securities, or portions thereof, for whose payment or redemption money or U.S. Governmental Obligations in the necessary amount has been theretofore deposited with the Trustee or any Paying Agent (other than the Company) in trust or set aside and segregated in trust by the Company (if the Company shall act as its own Paying Agent) for the Holders of such Securities; *provided* that, if such Securities are to be redeemed, notice of such redemption has been duly given pursuant to this Indenture or provision therefor satisfactory to the Trustee has been made; and
- (iii) Securities that have been paid pursuant to Section 306 or in exchange for or in lieu of which other Securities have been authenticated and delivered pursuant to this Indenture, other than any such Securities in respect of which there shall have been presented to the Trustee proof satisfactory to it that such Securities are held by a bona fide purchaser in whose hands such Securities are valid obligations of the Company;

*provided, however*, that in determining whether the Holders of the requisite principal amount of the Outstanding Securities have given any request, demand, authorization, direction, notice, consent or waiver hereunder, (a) the principal amount of an Original Issue Discount Security that shall be deemed to be outstanding for such purposes shall be the amount of the principal thereof that would be due and payable as of the date of such determination upon a declaration of acceleration of the Maturity thereof pursuant to Section 502, and (b) Securities owned by the Company or any other obligor upon the Securities or any Affiliate of the Company or of such other obligor shall be disregarded and deemed not to be Outstanding, except that in determining whether the Trustee shall be protected in relying upon any such request, demand, authorization, direction, notice, consent or waiver, only Securities that a Responsible Officer of the Trustee actually knows to be so owned shall be so disregarded. Securities so owned as described in (b) above which have been pledged in good faith may be regarded as Outstanding if the pledgee certifies to the Trustee the pledgee’s right so to act with respect to such Securities and that the pledgee is not the Company or any other obligor upon the Securities or any Affiliate of the Company or of such other obligor.

“*Participant*” means a Person that has an account with DTC.

“*Paying Agent*” means Deutsche Bank Luxembourg S.A. and any other Person authorized by the Company to pay the

principal of (and premium, if any) or interest on any Securities on behalf of the Company hereunder, including, without limitation, the Principal Paying Agent.

“*Permanent Global Security*” means a Global Security that is, at the time of the initial issuance of the related series of Securities, issued in permanent form.

“*Person*” means any individual, corporation, limited liability company, partnership, joint venture, association, joint-stock company, trust, unincorporated organization or government or any agency or political subdivision thereof.

“*Place of Payment*,” when used with respect to the Securities of any series, means the place or places where the principal of (and premium, if any) and interest, if any, on the Securities of that series are payable as specified in or as contemplated by Section 301.

“*Predecessor Security*” of any particular Security means every previous Security evidencing all or a portion of the same debt as that evidenced by such particular Security; and, for the purpose of this definition, any Security authenticated and delivered under Section 306 in exchange for or in lieu of a mutilated, destroyed, lost or stolen Security shall be deemed to evidence the same debt as the mutilated, destroyed, lost or stolen Security.

“*Principal Paying Agent*” means Bankers Trust Company until a successor Principal Paying Agent shall have become such pursuant to the applicable provisions of this Indenture and, thereafter, “*Principal Paying Agent*” shall mean such successor Principal Paying Agent.

“*Redemption Date*,” when used with respect to any Security to be redeemed, means the date fixed for such redemption by or pursuant to this Indenture.

“*Redemption Price*,” when used with respect to any Security to be redeemed, means the price at which it is to be redeemed pursuant to this Indenture, exclusive of accrued and unpaid interest.

“*Registered Security*” means any Security that is payable to a registered owner or registered assigns thereof as registered in the Security Register.

“*Regular Record Date*” for the interest payable on any Interest Payment Date on the Securities of any series means the date specified for that purpose as contemplated by Section 301.

“*Relevant Date*” for any payment made with respect to the Securities of any series means whichever is the later of (i) the date on which the relevant payment first becomes due and (ii) if the full amount payable has not been received in The City of New York by the Book-Entry Depository or the Trustee on or prior to such due date, the date on which, the full amount having been so received, notice to that effect shall have been given to the Holders in accordance with this Indenture.

“*Resale Restriction Termination Date*” means the date which is two years after the later of (i) the date such Securities are originally issued by the Company or (ii) the last date on which the Company or any Affiliate of the Company was the owner of such Security.

“*Responsible Officer*,” when used with respect to the Trustee, means any officer within the Corporate Trust Office, including any vice president, managing director, the secretary, the treasurer, assistant vice president, assistant secretary, assistant treasurer, or any other officer of the Trustee customarily performing functions similar to those performed by any of the above-designated officers with responsibility for the administration of this Indenture, and also means, with respect to a particular corporate trust matter, any other officer to whom such matter is referred because of his knowledge of and familiarity with the particular subject.

“*Restricted Period*” with respect to any Regulation S Security, shall mean the first 40 days following the date on which such Securities are originally issued by the Company.

“*Securities*” has the meaning stated in the first recital of this Indenture and, more particularly, means any Securities authenticated and delivered under this Indenture.

“*Securities Act*” means the Securities Act of 1933, as amended.

“*Security Register*” and “*Security Registrar*” have the respective meanings specified in Section 306.

“*Special Record Date*” for the payment of any Defaulted Interest means a date fixed by the Trustee pursuant to Section 308.

“*Stated Maturity*,” when used with respect to any Security or any installment of principal thereof or interest thereon, means the date specified in such Security as the fixed date on which the principal of such Security or such installment of principal or interest is due and payable.

“*Subsidiary*” means a corporation more than 50% of the outstanding Voting Stock of which is owned, directly or indirectly, by the Company.

“*Transfer Agent*” means any Person authorized by the Company to effectuate the exchange or transfer of any Security on behalf of the Company hereunder.

“*Trustee*” means the Person named as the “*Trustee*” in the first paragraph of this instrument until a successor Trustee shall have become such pursuant to the applicable provisions of this Indenture, and thereafter “*Trustee*” shall mean or include each Person that is then a Trustee hereunder, and if at any time there is more than one such Person, “*Trustee*” as used with respect to the Securities of any series shall mean the Trustee with respect to Securities of that series.

“*Trust Indenture Act*” means the Trust Indenture Act of 1939, as in force at the date as of which this instrument was executed, except as provided in Section 905.

“*United Kingdom*” means the United Kingdom of Great Britain and Northern Ireland, its territories, its possessions, and other areas subject to its jurisdiction.

“*United Kingdom Taxes*” has the meaning specified in Section 1009.

“*United States*” means the United States of America (including the States and the District of Columbia), its territories, its possessions, and other areas subject to its jurisdiction.

“*U.S. Government Obligations*” means direct obligations of the United States for the payment of which the full faith and credit of the United States of America is pledged, or obligations of a person controlled or supervised by and acting as an agency or instrumentality of the United States and the payment of which is unconditionally guaranteed by the United States, and shall also include a depository receipt issued by a bank or trust company as custodian with respect to any such U.S. Government Obligation or a specific payment of interest on or principal of any such U.S. Government Obligation held by such custodian for the account of a holder or a depository receipt; provided that (except as required by law) such custodian is not authorized to make any deduction from the amount payable to the holder of such depository receipt from any amount received by the custodian in respect of the U.S. Government Obligation or the specific payment of interest on or principal of the U.S. Government Obligation evidenced by such depository receipt.

“*Voting Stock*” of any corporation means stock of the class or classes having general voting power under ordinary circumstances to elect at least a majority of the board of directors of a corporation (irrespective of whether at the time stock of any other class or classes shall have or might have voting power by reason of the happening of any contingency).

#### SECTION 102. Compliance Certificates and Opinions

Except as otherwise expressly provided by this Indenture, upon any application or request by the Company to the Trustee to take any action under any provision of this Indenture, the Company shall furnish to the Trustee an Officers’ Certificate stating that all conditions precedent, if any, provided for in this Indenture relating to the proposed action have been complied with and an Opinion of Counsel stating that, in the opinion of such counsel, all such conditions precedent, if any, have been complied with, except that in the case of any such application or request as to which the furnishing of such documents is specifically required by any provision of this Indenture relating to such particular application or request, no additional certificate or opinion need be furnished.

Every certificate or opinion with respect to compliance with a condition or covenant provided for in this Indenture shall include:

- (i) a statement that each individual signing such certificate or opinion has read such covenant or condition and the definitions herein relating thereto;
- (ii) a brief statement as to the nature and scope of the examination or investigation upon which the statements or opinions contained in such certificate or opinion are based;
- (iii) a statement that, in the opinion of each such individual, or such firm he, she or it has made such examination or investigation as is necessary to enable him, her or it to express an informed opinion as to whether or not such covenant or condition has been complied with; and
- (iv) a statement as to whether, in the opinion of each such individual or such firm, such condition or covenant has been complied with.

#### SECTION 103. Form of Documents Delivered to Trustee

In any case where several matters are required to be certified by, or covered by an opinion of, any specified Person, it is not necessary that all such matters be certified by, or covered by the opinion of, only one such Person, or that they be so certified or covered by only one document, but one such Person may certify or give an opinion with respect to some matters and one or more other such Persons as to other matters, and any such Person may certify or give an opinion as to such matters in one or several documents.

Any certificate or opinion of an officer or Director of the Company may be based, insofar as it relates to legal matters, upon a certificate or opinion of, or representations by, counsel, unless such officer or Director knows, or in the exercise of reasonable care should know, that the certificate or opinion or representations with respect to the matters upon which his certificate or opinion is based are erroneous. Any such certificate or opinion of counsel may be based, insofar as it relates to factual matters, upon a certificate or opinion of, or representations by, an officer or officers or Director or Directors of the Company stating that the information with respect to such factual matters is in the possession of the Company, unless such counsel knows, or in the exercise of reasonable care should know, that the certificate



or opinion or representations with respect to such matters are erroneous.

Where any Person is required to make, give or execute two or more applications, requests, consents, certificates, statements, opinions or other instruments under this Indenture, they may, but need not, be consolidated and form one instrument.

SECTION 104. Acts of Holders

(a) Any request, demand, authorization, direction, notice, consent, waiver or other action provided by this Indenture to be given or taken by Holders may be embodied in and evidenced by one or more instruments of substantially similar tenor signed by such Holders in person or by agent duly appointed in writing, and, except as herein otherwise expressly provided, such action shall become effective when such instrument or instruments are delivered to the Trustee and, where it is hereby expressly required, to the Company. Such instrument or instruments (and the action embodied therein and evidenced thereby) are herein sometimes referred to as the “*Act*” of the Holders signing such instrument or instruments. Proof of execution of any such instrument or of a writing appointing any such agent shall be sufficient for any purpose of this Indenture and (subject to Section 601) conclusive in favor of the Trustee and the Company, if made in the manner provided in this Section 104.

Without limiting the generality of the foregoing, unless otherwise established in or pursuant to a Board Resolution or set forth or determined in an Officers’ Certificate, or established in one or more indentures supplemental hereto, pursuant to Section 301, a Holder, including a Book-Entry Depository that is a Holder of a Global Security, may make, give or take, by a proxy, or proxies, duly appointed in writing, any request, demand, authorization, direction, notice, consent, waiver or other action provided in this Indenture to be made, given or taken by Holders, and a Book-Entry Depository that is a Holder of a Global Security may provide its proxy or proxies to the beneficial owners of interests in any such Global Security through such Book-Entry Depository’s standing instructions and customary practices.

(b) The fact and date of the execution by any Person of any such instrument, writing or proxy may be proved by the affidavit of a witness of such execution or by a certificate of a notary public or other officer authorized by law to take acknowledgments of deeds, certifying that the individual signing such instrument, writing or proxy acknowledged to him the execution thereof.

Where such execution is by a signer acting in a capacity other than his or her individual capacity, such certificate or affidavit shall also constitute sufficient proof of his or her authority. The fact and date of the execution of any such instrument, writing or proxy, or the authority of the Person executing the same, may also be proved in any other manner that the Trustee deems sufficient.

(c) The ownership of Registered Securities shall be proved by the Security Register.

(d) Any Request, demand, authorization, direction, notice, consent, waiver or other Act of the Holders of any Security all bind every future Holder of the same Security and the Holder of every Security issued upon the registration of transfer thereof or in exchange therefor or in lieu thereof in respect of anything done, omitted or suffered to be done by the Trustee or the Company in reliance thereon, whether or not notation of such action is made upon such Security.

(e) The principal or face amount and serial numbers of Bearer Securities of any series held by any Person, and the date of holding the same, may be proved by the production of such Bearer Securities or by a certificate executed by the Book-Entry Depository for such Bearer Securities.

(f) If the Company shall solicit from the Holders of Securities of any series any request, demand, authorization, direction, notice, consent, waiver or other Act, the Company may, at its option, by Board Resolution, fix in advance a record date for purposes of determining the identity of Holders of Securities entitled to give such request, demand, authorization, direction, notice, consent, waiver or other Act, but the Company shall have no obligation to do so. Any such record date shall be fixed at the Company’s discretion. If such a record date is fixed, such request, demand, authorization, direction, notice, consent, waiver or other Act may be sought or given before or after the record date, but only the Holders of Securities of record at the close of business on such record date shall be deemed to be Holders of Securities for the purpose of determining whether Holders of the requisite proportion of Securities of such series Outstanding have authorized or agreed or consented to such request, demand, authorization, direction, notice, consent, waiver or other Act, and for that purpose the Securities of such series Outstanding shall be computed as of such record date.

With regard to any record date set pursuant to this subsection, the Holders of Outstanding Securities of the relevant series on such record date (or their duly appointed agents), and only such Persons, shall be entitled to take relevant action, whether or not such Holders remain Holders after such record date. With regard to any action that may be taken hereunder only by Holders of a requisite principal amount of Outstanding Securities of any series (or their duly appointed agents), and for which a record date is set pursuant to this subsection, the Company may, at its option, set an expiration date after which no such action purported to be taken by any Holder shall be effective hereunder unless taken on or prior to such expiration date by Holders of the requisite principal amount of Outstanding Securities of such series on such record date (or their duly appointed agents).

On or prior to any expiration date set pursuant to this subsection, the Company may, on one or more occasions at its option, extend such expiration date to any later date. Nothing in this subsection shall prevent any Holder (or any duly appointed agent thereof) from taking, at any time, any action contrary to or different from, any action previously taken, or purported to have been taken, hereunder by such Holder, in which event the Company may set a record date in respect thereof pursuant to this subsection. Notwithstanding the foregoing or the Trust Indenture Act, the Company shall not set a record date for, and the provisions of this paragraph shall not apply with respect to, any action to be taken by Holders pursuant to Sections 501, 502 or 512.

Upon receipt by the Trustee of written notice of any default described in Section 501, any declaration of acceleration, of any

rescission and annulment of any such declaration, pursuant to Section 502, or of any direction in accordance with Section 512, a record date shall automatically and without any other action by any Person be set for the purpose of determining the Holders of outstanding Securities of the series entitled to join in such notice, declaration, rescission and annulment, or direction, as the case may be, which record date shall be the close of business on the day the Trustee receives such notice, declaration, rescission and annulment, or direction, as the case may be. The Holders of Outstanding Securities of such series on such record date (or their duly appointed agent), and only such Persons, shall be entitled to join in such notice, declaration, rescission and annulment, or direction, as the case may be, whether or not such Holders remain Holders after such record date; *provided that*, unless such notice, declaration, rescission and annulment, or direction, as the case may be, shall have become effective by virtue of Holders of the requisite principal amount of outstanding Securities of such series on such record date (or their duly appointed agents) having joined therein on or prior to the 90<sup>th</sup> day after such record date, such notice of default, declaration, rescission and annulment, or direction given or made by the Holders, as the case may be, shall automatically and without any action by any Person be canceled and of no further effect. Nothing in this paragraph shall prevent a Holder (or a duly appointed agent thereof) from giving, before or after the expiration of such 90-day period, a notice of default, a declaration of acceleration, a rescission and annulment of a declaration of acceleration, or a direction in accordance with Section 512, contrary to or different from, or, after the expiration of such period, identical to, a previously given notice, declaration, rescission and annulment, or direction, as the case may be, that has been canceled pursuant to the proviso to the preceding sentence, in which event a new record date in respect thereof shall be set pursuant to this paragraph.

#### SECTION 105. Notices, Etc., to the Trustee and the Company

Any request, demand, authorization, direction, notice, consent, waiver or Act of Holders or other document provided or permitted by this Indenture to be made upon, given or furnished to, or filed with:

- (i) the Trustee by any Holder or by the Company shall be sufficient for every purpose hereunder if made, given, furnished or filed in writing to or with the Trustee at its Corporate Trust Office; or
- (ii) the Company by the Trustee or by any Holder shall be sufficient for every purpose hereunder (unless otherwise herein expressly provided) if in writing and mailed, first-class postage prepaid, or delivered by recognized overnight courier, to the Company addressed to it at the address of its principal office specified in the first paragraph of this Indenture or at any other address previously furnished in writing to the Trustee by the Company.

#### SECTION 106. Notice to Holders; Waiver

Where this Indenture provides for notice to Holders of any event, such notice shall be sufficiently given (unless otherwise herein expressly provided) if in writing and mailed, first-class postage prepaid, to each Holder affected by such event, (i) in the case of a Holder of Registered Securities, at his address as it appears in the Security Register, and (ii) in the case of a Holder of Global Bearer Securities, at the address provided in or pursuant to the relevant Deposit Agreement of the relevant Book-Entry Depository or Depositories therefor, not later than the latest date, and not earlier than the earliest date, prescribed for the giving of such notice. In any case where notice to Holders is given by mail, neither the failure to mail such notice, nor any defect in any notice so mailed, to any particular Holder shall affect the sufficiency of such notice with respect to other Holders. Any notice mailed to a Holder in the manner herein prescribed shall be conclusively deemed to have been received by such Holder, whether or not such Holder actually receives such notice.

If, by reason of the suspension of regular mail service or by reason of any other cause, it shall be impracticable to give such notice by mail, then such notification as shall be made at the direction of the Company in a manner reasonably calculated, to the extent practicable under the circumstances, to provide prompt notice shall constitute a sufficient notification for every purpose hereunder.

Except as otherwise expressly provided herein or otherwise specified with respect to any Securities pursuant to Section 301, where this Indenture provides for notice to Holders of Bearer Securities of any event and the rules of any securities exchange on which such Bearer Securities are listed so require, such notice shall be sufficiently given to Holders of such Bearer Securities if published in such newspaper or newspapers as may be specified in such Securities on a Business Day at least twice, the first such publication to be not earlier than the earliest date, and not later than the latest date, prescribed for the giving of such notice. Any such notice by publication shall be deemed to have been given on the date of the first such publication. In addition, notice to the Holder of any Global Bearer Security shall be given by mail in the manner provided above.

If by reason of any cause, it shall be impracticable to publish any notice to Holders of Bearer Securities as provided above, then such notification to Holders of Bearer Securities as shall be given with the approval of the Trustee shall constitute sufficient notice to such Holders for every purpose hereunder. Neither the failure to give notice by publication to Holders of Bearer Securities as provided above, nor any defect in any notice so published, shall affect the sufficiency of such notice with respect to other Holders of Bearer Securities or the sufficiency of any notice to Holders of Registered Securities given as provided herein.

Any request, demand, authorization, direction, notice, consent, waiver or Act required or permitted under this Indenture shall be in the English language, except that any published notice may be in an official language of the country of publication.

Where this Indenture provides for notice in any manner, such notice may be waived in writing by the Person entitled to receive such notice, either before or after the event, and such waiver shall be the equivalent of such notice. Waivers of notice by Holders shall be filed with the Trustee, but such filing shall not be a condition precedent to the validity of any action taken in reliance upon such waiver.

#### SECTION 107. Conflict with Trust Indenture Act

If any provision hereof limits, qualifies or conflicts with any provision of the Trust Indenture Act or another provision that is

required or deemed to be included in this Indenture by any of the provisions of the Trust Indenture Act, the provision or requirement of the Trust Indenture Act shall control. If any provision of this Indenture modifies or excludes any provision of the Trust Indenture Act that may be so modified or excluded, such provision of the Trust Indenture Act shall be deemed to apply to this Indenture as so modified or excluded, as the case may be.

SECTION 108. Effect of Headings and Table of Contents

The Article and Section headings herein and the Table of Contents are for convenience only and shall not affect the construction hereof.

SECTION 109. Successors and Assigns

All covenants and agreements in this Indenture by the Company shall bind its successors and assigns, whether so expressed or not.

SECTION 110. Separability Clause

In case any provision in this Indenture or in the Securities shall be invalid, illegal or unenforceable, the validity, legality, and enforceability of the remaining provisions shall not in any way be affected or impaired thereby.

SECTION 111. Benefits of Indenture

Nothing in this Indenture or in the securities, express or implied, shall give to any Person, other than the parties hereto and their successors hereunder and the Holders, any benefit or any legal or equitable right, remedy or claim under this Indenture.

SECTION 112. Governing Law

**This Indenture and the Securities shall be governed by and construed in accordance with the laws of the State of New York.**

SECTION 113. Legal Holidays

In any case where any Interest Payment Date, Redemption Date or Stated Maturity of any Security shall not be a Business Day at any Place of Payment, then (notwithstanding any other provision of this Indenture or of the Securities) payment of interest, if any, or principal (and premium, if any) need not be made at such Place of Payment on such date, but may be made on the next succeeding Business Day at such Place of Payment with the same force and effect as if made on the Interest Payment Date, Redemption Date, or at the Stated Maturity, and no interest shall accrue for the period from and after such Interest Payment Date, Redemption Date or Stated Maturity, as the case may be.

SECTION 114. No Personal Liability of Directors, Officers, Employees & Stockholders

No Director, officer, employee or stockholder, as such, of the Company shall have any liability for any obligations of the Company under this Indenture or the Securities or for any claim based on, or in respect of, or by reason of, such obligations on their creations. Each holder of a Security waives and releases all such liability. Such waiver and release are part of the consideration for the issuance of the Securities.

## ARTICLE II

### SECURITY FORMS

SECTION 201. Forms Generally

The Securities of each series shall be in substantially the form set forth in this Article, or in such other form as shall be established by or pursuant to a Board Resolution or in one or more indentures supplemental hereto, in each case with such appropriate insertions, omissions, substitutions and other variations as are required or permitted by this Indenture, a Board Resolution or one or more indentures supplemental hereto, and may have such letters, numbers or other marks of identification and such legends or endorsements placed thereon as may be required to comply with the rules of any securities exchange or as may, consistently herewith, be determined by the Director or Directors executing such Securities, as evidenced by the Director's or Directors' execution of the Securities. If the form of Securities of any series is established by action taken pursuant to a Board Resolution, a copy of an appropriate record of such action shall be certified by an authorized Director or officer of the Company and delivered to the Trustee at or prior to the delivery of the Company Order contemplated by Section 303 for the authentication and delivery of such securities.

The Trustee's certificates of authentication shall be in substantially the form set forth in this Article.

Securities of any series offered and sold to qualified institutional buyers (as defined in Rule 144A under the Securities Act) (any such buyer, a "QIB") in the United States of America ("Rule 144A Securities") will be issued in the form of a permanent global bearer

note, without interest coupons, substantially in the form set forth in Sections 202 and 203 (a “*Rule 144A Global Security*”) duly executed by the Company and authenticated by the Trustee as hereinafter provided. The Rule 144A Global Security may be represented by more than one certificate. The aggregate principal amount of the Rule 144A Global Security may from time to time be increased or decreased by adjustments made on the records of the Trustee, as hereinafter provided.

Securities of any series offered and sold outside the United States of America (“*Regulation S Securities*”) in reliance on Regulation S shall be issued in the form of a temporary global bearer note, without interest coupons, substantially in the form set forth in Sections 202 and 203 (a “*Regulation S Temporary Global Security*”). Beneficial interests in a Regulation S Temporary Global Security will be exchangeable for beneficial interests in a single permanent global bearer security (the “*Regulation S Permanent Global Security*,” together with the Regulation S Temporary Global Security, the “*Regulation S Global Security*”) on or after the expiration of the Restricted Period (the “*Release Date*”) upon the receipt by the Trustee or its agent of a certificate certifying that the Holder of the beneficial interest in the Regulation S Temporary Global Security is a non-United States Person within the meaning of Regulation S (a “*Regulation S Certificate*”), substantially in the form set forth in Section 206. Upon receipt by the Trustee or Paying Agent of a Regulation S Certificate, (i) with respect to the first such Regulation S Certificate, the Company shall execute and upon receipt of a Company Order for authentication, the Authenticating Agent shall authenticate and deliver to the Trustee or its agent, the applicable Regulation S Permanent Global Security, and (ii) with respect to the first and all subsequent Regulation S Certificates, the Trustee or its agent shall exchange on behalf of the applicable beneficial owners the portion of the applicable Regulation S Temporary Global Security covered by such Regulation S Certificates for a comparable portion of the applicable Regulation S Permanent Global Security. Upon any exchange of a portion of a Regulation S Temporary Global Security for a comparable portion of a Regulation S Permanent Global Security, the Trustee or its agent shall endorse on the schedules affixed to each of such Regulation S Global Security (or on continuations of such schedules affixed to each of such Regulation S Global Security and made parts thereof) appropriate notations evidencing the date of transfer and (x) with respect to the applicable Regulation S Temporary Global Security, a decrease in the principal amount thereof equal to the amount covered by the applicable certification and (y) with respect to the applicable Regulation S Permanent Global Security, an increase in the principal amount thereof equal to the principal amount of the decrease in the applicable Regulation S Temporary Global Security pursuant to clause (x) above. The Regulation S Global Security will be duly executed by the Company and authenticated by the Trustee as hereinafter provided. The Regulation S Global Security may be represented by more than one certificate. The aggregate principal amount of the Regulation S Global Security may from time to time be increased or decreased by adjustments made on the records of the Trustee, as hereinafter provided.

The Rule 144A Global Security and the Regulation S Global Security are sometimes collectively herein referred to as the “*Global Securities*.”

The definitive Securities shall be printed, lithographed or engraved on steel engraved borders or may be produced in any other manner, all as determined by the Director or Directors executing such Securities, as evidenced by the Director’s or Directors’ execution of such Securities.

#### SECTION 202. Form of Face of Security

[ *If the Security is to be a Rule 144A Global Security, insert X* This Security is a Global Security within the meaning of the Indenture hereinafter referred to and is [ held by ] registered in the name [ ] of a Book-Entry Depository or a nominee of a Book-Entry Depository. This Security is exchangeable for securities [ held by ] registered in the name of [ ] a person other than the Book-Entry Depository or its nominee only in the limited circumstances described in the Indenture, and no transfer of this Security (other than a transfer of this Security as a whole by the Book-Entry Depository to a nominee of the Book-Entry Depository or by a nominee of the Book-Entry Depository to the Book-Entry Depository or another nominee of the Book-Entry Depository) may be [ made ] registered [ ], except in limited circumstances.

Unless this Global Security is presented by an authorized representative of the Book-Entry Depository to the issuer or its agent for [ registration of transfer ], exchange or payment, and any definitive security is issued in the name or names as directed in writing by the Book-Entry Depository, ANY TRANSFER, PLEDGE, OR OTHER USE HEREOF FOR VALUE OR OTHERWISE BY OR TO ANY PERSON IS WRONGFUL in as much as the [ bearer ] registered owner [ ] hereof, the Book-Entry Depository, has an interest herein. ]

[ *If the security is a Global Security, insert X*

THIS SECURITY HAS NOT BEEN REGISTERED UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE “*SECURITIES ACT*”). THE HOLDER HEREOF, BY PURCHASING THIS SECURITY, AGREES FOR THE BENEFIT OF THE COMPANY THAT THIS SECURITY MAY NOT BE RESOLD, PLEDGED OR OTHERWISE TRANSFERRED (X) PRIOR TO THE SECOND ANNIVERSARY OF THE ISSUANCE HEREOF (OR A PREDECESSOR SECURITY HERETO) OR (Y) BY ANY HOLDER THAT WAS AN AFFILIATE OF THE COMPANY AT ANY TIME DURING THE THREE MONTHS PRECEDING THE DATE OF SUCH TRANSFER, IN EITHER CASE OTHER THAN (1) TO THE COMPANY, (2) SO LONG AS THIS SECURITY IS ELIGIBLE FOR RESALE PURSUANT TO RULE 144A UNDER THE SECURITIES ACT (“*RULE 144A*”) TO A PERSON WHOM THE SELLER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER TO WHOM NOTICE IS GIVEN THAT THE RESALE, PLEDGE OR OTHER TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A (AS INDICATED BY THE BOX CHECKED BY THE TRANSFEROR ON THE CERTIFICATE OF TRANSFER ON THE REVERSE OF THIS SECURITY), (3) IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH REGULATION S UNDER THE SECURITIES ACT (AS INDICATED BY THE BOX CHECKED BY THE TRANSFEROR ON THE CERTIFICATE OF TRANSFER ON THE REVERSE OF THIS SECURITY), OR (4) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144 (IF APPLICABLE) UNDER THE SECURITIES ACT, IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE LAWS OF ANY

STATE OF THE UNITED STATES. ]

*[ If the Security is a Regulation S Temporary Global Security, insert X*

THIS GLOBAL NOTE IS A TEMPORARY GLOBAL NOTE FOR PURPOSES OF REGULATION S UNDER THE SECURITIES ACT. NEITHER THIS TEMPORARY GLOBAL NOTE NOR ANY INTEREST HEREIN MAY BE OFFERED, SOLD OR DELIVERED, EXCEPT AS PERMITTED UNDER THE INDENTURE HEREINAFTER REFERRED TO.

NO BENEFICIAL OWNERS OF THIS TEMPORARY GLOBAL NOTE SHALL BE ENTITLED TO RECEIVE PAYMENT OF PRINCIPAL OR INTEREST HEREON UNLESS THE REQUIRED CERTIFICATIONS HAVE BEEN DELIVERED PURSUANT TO THE TERMS OF THE INDENTURE. ]

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WPD HOLDINGS UK

[ Title of the Security ]

No. [ \_\_\_\_\_ ]

\$ [ \_\_\_\_\_ ]

WPD HOLDINGS UK, a company duly organized and existing under the laws of England and Wales (herein called the “*Company*,” which term includes any successor corporation under the Indenture hereinafter referred to), for value received, hereby promises to pay [ the bearer upon surrender hereof ] [ name of registered owner or its registered assigns ], the principal sum of [ \_\_\_\_\_ ] Dollars on [ \_\_\_\_\_ ], and to pay interest thereon from [ \_\_\_\_\_ ], or from the most recent Interest Payment Date to which interest has been paid or duly provided for, semi-annually on [ \_\_\_\_\_ ] and [ \_\_\_\_\_ ] of each year, commencing on [ \_\_\_\_\_ ], at the rate *per annum* provided in the title hereof, until the principal hereof is paid or made available for payment. The interest so payable, and punctually paid or duly provided for, on any Interest Payment Date will, as provided in such Indenture, be paid to [ the bearer on such Interest Payment Date, ] [ the Person in whose name this Security (or one or more Predecessor Securities) is registered at the close of business on the Regular Record Date for such interest, which shall be the [ \_\_\_\_\_ ] or [ \_\_\_\_\_ ] (whether or not a Business Day), as the case may be, immediately preceding such Interest Payment Date ] . Any such interest not so punctually paid or duly provided for will forthwith cease to be payable to [ the bearer on such Interest Payment Date ] [ the Person in whose name this Security (or one or more Predecessor Securities) is registered on such Regular Records Date ] and may be paid to [ the bearer at the time of payment of such Defaulted Interest ] [ the Person in whose name this Security (or one or more Predecessor Securities) is registered at the close of business on a Special Record Date for the payment of such Defaulted Interest to be fixed by the Trustee, notice whereof shall be given to Holders of Securities of this series not less than 10 days prior to such Special Record Date ] , or be paid at any time in any other lawful manner not inconsistent with the requirements of any securities exchange on which the Securities of this series may be listed, and upon such notice as may be required by such exchange, all as more fully provided in said Indenture.

[ *If the Security is not to bear interest prior to maturity, insert* — The principal of this Security shall not bear interest except in the case of a default in payment of principal upon acceleration, upon redemption or at Stated Maturity and in such case the overdue principal of this Security shall bear interest at the rate of [ yield to maturity ] % *per annum* (to the extent that the payment of such interest shall be legally enforceable), which shall accrue from the date of such default in payment to the date payment of such principal has been made or duly provided for. Interest on any overdue principal shall be payable on demand. Any such interest on any overdue principal that is not so paid on demand shall bear interest at the rate of [ yield to maturity ] % *per annum* (to the extent that the payment of such interest shall be legally enforceable), which shall accrue from the date of such demand for payment to the date payment of such interest has been made or duly provided for, and such interest shall also be payable on demand. ]

Payment of the principal of (and premium, if any) and interest, if any, on this Security will be made at the office or agency of the Company maintained for that purpose in [ \_\_\_\_\_ ] in such coin or currency of the United States of America as at the time of payment is legal tender for the payment of public and private debts [ *If this Security is not a Global Security, insert* –; provided, *however* , that at the option of the Company payment of interest may be made by check mailed to the address of the person entitled thereto as such address shall appear in the Security Register ] [ *If this Security is a Global Security, insert applicable manner of payment* ] .

All payments of principal and interest (including payments of discount and premium, if any) in respect of this Security shall be made free and clear of, and without withholding or deduction for or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or within the United Kingdom or by or within any political subdivision thereof or any authority therein or thereof having power to tax (“*United Kingdom Taxes*”), unless such withholding or deduction is required by law. In the event of any such withholding or deduction, the Company shall pay to the Holder such additional amounts (the “*Additional Amounts*”) as will result in the payment to such Holder of the amount that would otherwise have been receivable by such Holder in the absence of such withholding or deduction, except that no such Additional Amounts shall be payable:

- (i) to, or to a Person on behalf of, a Holder who is liable for such United Kingdom Taxes in respect of this Security by reason of such Holder having some connection with the United Kingdom (including being a citizen or resident or national of, or carrying on a business or maintaining a permanent establishment in, or being physically present in, the United Kingdom) other than the mere holding of this Security or the receipt of principal and interest (including payments of discount and premium, if any) in respect thereof;
- (ii) to, or to a Person on behalf of, a Holder who presents this Security (where presentation is required) for payment more than 30 days after the Relevant Date (as defined below), except to the extent that such Holder would have been entitled to such Additional Amounts on presenting this Security for payment on the last day of such period of 30 days;
- (iii) to, or to a Person on behalf of, a Holder who presents this Security (where presentation is required) in the United Kingdom; or
- (iv) to, or to a Person on behalf of, a Holder who would not be liable or subject to the withholding or deduction by making a declaration of non-residence or similar claim for exemption to the relevant tax authority.

Such Additional Amounts will also not be payable where, had the beneficial owner of this Security (or any interest therein) been the Holder of the Security, he or she would not have been entitled to payment of Additional Amounts by reason of any one or more of clauses (i) through (iv) above. If the Company shall determine that Additional Amounts will not be payable because of the immediately preceding sentence, the Company will inform such holder promptly after making such determination setting forth the reason(s) therefor.

“*Relevant Date*” means whichever is the later of (i) the date on which such payment first becomes due and (ii) if the full amount payable has not been received in The City of New York by the Book-Entry Depository or the Trustee on or prior to such due date, the date on which, the full amount having been so received, notice to that effect shall have been given to the Holders in accordance with the Indenture.

[ *Insert any special notice provisions required by any stock exchanges upon which the Securities of a series are to be listed.* ]

**Reference is hereby made to the further provisions of this Security set forth on the reverse hereof, which further provisions shall for all purposes have the same effect as if set forth at this place.**

Unless the certificate of authentication hereon has been executed by the Trustee referred to on the reverse hereof by manual signature, this Security shall not be entitled to any benefit under the Indenture or be valid or obligatory for any purpose.

IN WITNESS WHEREOF, the Company has caused this instrument to be duly executed by an officer or director duly authorized.

Date:

WPD HOLDINGS UK

By \_\_\_\_\_  
[ Title ]

SECTION 203. Form of Reverse of Security

WPD HOLDINGS UK  
[ Title of the Security ]

This Security is one of a duly authorized issue of securities of the Company (herein called the “*Securities*”), issued and to be issued in one or more series under an Indenture, dated as of March [ \_\_\_ ], 2001 (herein called the “*Indenture*”), among the Company, Bankers Trust Company, as trustee (herein called the “*Trustee*,” which term includes any successor trustee under the Indenture,) and Deutsche Bank Luxembourg S.A., as paying and transfer agent (herein called the “*Paying Agent*,” which term includes any successor paying and transfer agent under the Indenture), [ *insert – particulars with respect to any indentures supplemental thereto pursuant to which the Securities of this series are being issued* ] to which Indenture and all indentures supplemental thereto reference is hereby made for a statement of the respective rights, limitations of rights, duties and immunities thereunder of the Company, the Trustee, the Paying Agent, and the Holders of the Securities and of the terms upon which the Securities are, and are to be, authenticated and delivered. Terms defined in the Indenture that are not defined herein are used with the meanings assigned to them in the Indenture. This Security is one of the series designated on the face hereof limited in aggregate principal amount to \$ [ \_\_\_\_\_ ] .

[ *If applicable, insert X* This Security is not subject to redemption prior to maturity. ] [ *If applicable, insert X* The Securities of this series are subject to redemption upon not less than 30 or more than 60 days’ notice to the Holders of such Securities as provided in the Indenture. [ *If applicable, insert X* (1) on [ \_\_\_\_\_ ] in any year commencing with the year [ \_\_\_\_ ] and ending with the year [ \_\_\_\_ ] through operation of the sinking fund for this series at a Redemption Price equal to 100% of the principal amount, and (2) [ at any time [ on or after \_\_\_\_\_, 20\_\_ ], as a whole or in part, at the election of the Company, at the following Redemption Prices (expressed as percentages of the principal amount):

If redeemed [ *if applicable, insert X* on or before [ \_\_\_\_\_ ] , [ \_\_\_\_ ] %, and if redeemed ] during the 12-month period beginning [ \_\_\_\_\_ ] , of the years indicated:

<u>Year</u>	<u>Redemption Price</u>	<u>Year</u>	<u>Redemption Price</u>
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and thereafter at a Redemption Price equal to [ \_\_\_\_ ] % of the principal amount, together in the case of any such redemption [ *if applicable, insert X* (whether through operation of the sinking fund or otherwise) ] with accrued and unpaid interest to the Redemption Date, but interest installments whose Stated Maturity is on or prior to such Redemption Date will be payable to the Holders of such Securities, or one or more Predecessor Securities, all as provided in the Indenture. ]

[ *If applicable, insert X* The Securities of this series are subject to redemption upon not less than 30 or more than 60 days’ notice to the Holders of such Securities, as provided in the Indenture (1) on [ \_\_\_\_\_ ] in any year commencing with the year [ \_\_\_\_ ] and ending with the year [ \_\_\_\_ ] through operation of the sinking fund for this series at the Redemption Prices for redemption through operation of the sinking fund (expressed as percentages of the principal amount) set forth in the table below, and (2) at any time [ on or after [ \_\_\_\_\_ ] ], as a whole or in part, at the election of the Company, at the Redemption Prices for redemption otherwise than through operation of the sinking fund (expressed as percentages of the principal amount) set forth in the table below:

If redeemed during the 12-month period beginning [ \_\_\_\_\_ ] of the years indicated:

Redemption Price for Redemption Through

Redemption Price For Redemption Otherwise

and thereafter at a Redemption Price equal to  $b$  [ \_\_\_ ] % of the principal amount, together in the case of any such redemption (whether through operation of the sinking fund or otherwise) with accrued and unpaid interest to the Redemption Date, but interest installments whose Stated Maturity is on or prior to such Redemption Date will be payable to the Holders of such Securities, or one or more Predecessor Securities, all as provided in the Indenture. ]

[ *If applicable, insert X* Notwithstanding the foregoing, the Company may not, prior to [ \_\_\_\_\_ ], redeem any Securities of this series as contemplated by [ Clause (2) of ] the preceding paragraph as a part of, or in anticipation of, any refunding operation by the application, directly or indirectly, of moneys borrowed having an interest cost to the Company (calculated in accordance with generally accepted financial practice) of less than [ \_\_\_ ] % *per annum* . ]

[ The sinking fund for this series provides for the redemption on [ \_\_\_\_\_ ] in each year beginning with the year [ \_\_\_ ] and ending with the year [ \_\_\_ ] of [ not less than ] [ \_\_\_\_\_ ] [ (“*mandatory sinking fund*”) and, at the option of the Company, not more than [ \_\_\_\_\_ ] aggregate principal amount of Securities of this series. [ Securities of this series acquired or redeemed by the Company otherwise than through [ mandatory ] sinking fund payments may be credited against subsequent [ mandatory ] sinking fund payments otherwise required to be made in the order in which they become due. ]]

[ *If applicable, insert X* The Securities of this series will be redeemable in whole or in part, at the option of the Company at any time, at a redemption price equal to the greater of (i) 100% of the principal amount of the Securities of this series being redeemed or (ii) the sum of the present values of the remaining scheduled payments of principal of and interest on the Securities of this series being redeemed discounted to the date of redemption on a semiannual basis (assuming a 360-day year consisting of twelve 30-day months) at a discount rate equal to the Treasury Yield plus [ \_\_\_ ] basis points, *plus* , for (i) or (ii) above, whichever is applicable, accrued interest on the Securities of this series to the date of redemption.

“*Comparable Treasury Issue*” means the United States Treasury security selected by an Independent Investment Banker (as defined below) as having a maturity comparable to the remaining term of the Securities of this series to be redeemed that would be utilized, at the time of selection and in accordance with customary financial practice, in pricing new issues of corporate debt securities of comparable maturity to the remaining term of the Securities of this series.

“*Comparable Treasury Price*” means, with respect to any Redemption Date (as defined below), (i) the average of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) on the third Business Day preceding such Redemption Date, as set forth in the daily statistical release (or any successor release) published by the Federal Reserve Bank of New York and designated “*Composite 3:30 p.m. Quotations for U.S. Government Securities*,” or (ii) if such release (or any successor release) is not published or does not contain such prices on such Business Day, the Reference Treasury Dealer Quotation (as defined below) for such Redemption Date.

“*Independent Investment Banker*” means an independent investment banking institution of national standing in the U.S. appointed by the Company and reasonably acceptable to the Trustee.

“*Reference Treasury Dealer Quotation*” means, with respect to the Reference Treasury Dealer (as defined below) and any Redemption Date, the average, as determined by the Trustee, of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount and quoted in writing to the Trustee by such Reference Treasury Dealer at 5:00 p.m. on the third Business Day preceding such Redemption Date).

“*Reference Treasury Dealer*” means a primary U.S. Government securities dealer in New York City appointed by the Company and reasonably acceptable to the Trustee.

“*Treasury Yield*” means, with respect to any date on which the Securities are redeemed (each, a “*Redemption Date*”) the rate *per annum* equal to the semi-annual equivalent yield to maturity of the Comparable Treasury Issue, assuming a price for the Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the Comparable Treasury Price for such Redemption Date.

Notice of redemption shall be given in accordance neither less than 15 days nor more than 30 days prior to the date fixed for redemption.

If fewer than all the Securities of this series are to be redeemed, selection of Securities of this series for redemption will be made by the Trustee in any manner the Trustee deems fair and appropriate and that complies with applicable legal and securities exchange requirements.

Unless the Company defaults in payment of the redemption price, from and after the Redemption Date, the Securities of this series or portions thereof called for redemption will cease to bear interest, and the Holders thereof will have no right in respect to such securities of this series except the right to receive the redemption price thereof. ]

[ *If applicable, insert -* In the event of redemption of this Security in part only, a new Security or Securities of this series and



of like tenor for the unredeemed portion hereof will be issued to the Holder hereof upon the cancellation hereof. ]

The Indenture contains provisions for defeasance of (i) the entire indebtedness of this security and (ii) certain restrictive covenants upon compliance by the Company with certain conditions set forth therein.

If an Event of Default with respect to Securities of this series shall occur and be continuing, the principal of the Securities of this series may be declared due and payable in the manner and with the effect provided in the Indenture. At any time after such declaration of acceleration with respect to Securities of this series has been made, but before a judgment or decree for payment of money has been obtained by the Trustee as provided in the Indenture, if all Events of Default with respect to Securities of this series have been cured or waived (other than the non-payment of principal of the Securities of this series which has become due solely by reason of such declaration of acceleration) then such declaration of acceleration and its consequences shall be automatically annulled and rescinded.

[ *If the Security is Issued with a Discount, insert* – If an Event of Default with respect to Securities of this series shall occur and be continuing, an amount of principal of the Securities of this series (the “Acceleration Amount”) may be declared due and payable in the manner and with the effect provided in the Indenture. In case of a declaration of acceleration on or before [ \_\_\_\_\_ ] in any year, the Acceleration Amount per \$ [ \_\_\_\_\_ ] principal amount at Stated Maturity of the Securities shall be equal to the amount set forth in respect of such date below:

Date of declaration	Acceleration Amount per \$ [ _____ ] principal amount at Stated Maturity
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and in case of a declaration of acceleration on any other date, the Acceleration Amount shall be equal to the Acceleration Amount as of the immediately preceding date set forth in the table above, plus accrued original issue discount (computed in accordance with the method used for calculating the amount of original issue discount that accrues for U.S. Federal income tax purposes) from such next preceding date to the date of declaration at the yield to maturity. For the purpose of this computation, the yield to maturity is [ \_\_\_\_ ] %. Upon payment (i) of the Acceleration Amount so declared due and payable and (ii) of interest on any overdue principal and overdue interest (in each case to the extent that the payment of such interest shall be legally enforceable), all of the Company’s obligations in respect of the payment of the principal of and interest, if any, on the Securities of this series shall terminate. ]

The Securities of this series are subject to redemption, in whole but not in part, upon not less than 15 nor more than 30 days’ notice given as provided in the Indenture to the Holders of Securities of this series at a price equal to the outstanding principal amount thereof together with Additional Amounts, if any, and accrued interest, to the Redemption Date if:

- (i) the Company satisfies the Trustee prior to the giving of such notice that it has or will become obliged to pay Additional Amounts as a result of either (x) any change in, or amendment to, the laws or regulations of the United Kingdom or any political subdivision or any authority or agency thereof or therein having power to tax or levy duties, or any change in the application or interpretation of such laws or regulations, which change or amendment becomes effective on or after the B [ ] date of issuance ] or, if applicable, the date of the underwriting agreement with respect to the Securities of this series, ] or (y) the issuance of definitive Registered Securities pursuant to any of clauses (i), (ii) or (iv) of the third following paragraph: and
- (ii) such obligation cannot be avoided by the Company taking reasonable measures available to it,

subject, as provided in the Indenture, to the delivery by the Company of an Officers’ Certificate stating that the obligation referred to in clause (i) above cannot be avoided by the Company taking reasonable measures available to it.

The Indenture permits, with certain exceptions as therein provided, the amendment thereof and the modification of the Indenture or any supplemental indenture or the rights and obligations of the Company and rights of the Holders of the Securities of each series to be affected under the Indenture at any time by the Company and the Trustee with the consent of the Holders of a majority in aggregate principal amount of the Securities at the time Outstanding of all series to be affected (voting as a class). The Indenture also contains provisions permitting the Holders of specified percentages in principal amount of the Securities of each series at the time Outstanding, on behalf of the Holders of all Securities of such series, to waive compliance by the Company with certain provisions of the Indenture and certain past defaults under the Indenture and their consequences. Any such consent or waiver by the Holder of this Security shall be conclusive and binding upon such Holder and upon all future Holders of this Security and of any Security issued upon the registration of transfer hereof or in exchange hereof or in lieu hereof, whether or not notation of such consent or waiver is made upon this Security.

No reference herein to the Indenture and no provision of this Security or of the Indenture shall alter or impair the obligation of the Company, which is absolute and unconditional, to pay the principal of (and premium, if any) and interest, if any, on this Security at the times, place, and rate, and in the coin or currency, herein prescribed.

[ *If this Security is a Global Security, insert X* This Security shall be exchangeable, in whole but not in part, for Securities of this series registered in the names of Persons other than the Book-Entry Depository with respect to such series or its nominee only as provided in this paragraph. This Security shall be so exchangeable if (i) DTC notifies the Company and the Book-Entry Depository that it is unwilling or unable to continue to hold the Book-Entry Interest or at any time it ceases to be a “clearing agency” registered under the Exchange Act and, in either case, a successor is not appointed by the Company within 120 days, (ii) the Book-Entry Depository for the securities of this series notifies the Company that it is unwilling or unable to continue as Book-Entry Depository with respect to this Security and no successor is

appointed within 120 days, (iii) the Company executes and delivers to the Trustee an Officers' Certificate providing that this Security shall be so exchangeable, or (iv) there shall have occurred and be continuing an Event of Default with respect to the Securities of this series and the Holder, in such circumstance, acting upon instructions from owners of interests representing a majority of outstanding principal amount of the Book-Entry Interests relating to this Security shall have requested in writing that this Security be exchanged for one or more definitive Registered Securities. Securities so issued in exchange for this Security shall be of the same series, having the same interest rate, if any, and maturity and having the same terms as this Security, in authorized denominations and in the aggregate having the same principal amount as this Security and registered in such names as the Book-Entry Depository for this Security shall direct. ]

[ *If this Security is a Registered Security, insert X* As provided in the Indenture and subject to certain limitations therein set forth, the transfer of [ *if this Security is a Registered Global Security, insert – a Security of the series of which this Security is a part* ] [ *If this Security is a Registered Security but not a Global Security, insert – this Security* ] is registrable in the Security Register, upon surrender of this Security for registration of transfer at the office or agency of the Company in any place where the principal of (and premium, if any) and interest, if any, on this Security are payable, duly endorsed by, or accompanied by a written instrument of transfer in form satisfactory to the Company and the Security Registrar duly executed by, the Holder hereof or his attorney duly authorized in writing, and thereupon one or more new Securities of this series and of like tenor, of authorized denominations and for the same aggregate principal amount, will be issued to the designated transferee or transferees. ]

The Securities of the series of which this Security is a party and which are not Global Securities are issuable only in registered form without coupons in denominations of \$ [ \_\_\_\_\_ ] and any integral multiple thereof. [ *If this Security is a Global Bearer Security, insert X* The bearer of this Security shall be treated as the owner of it for all purposes, subject to the terms of the Indenture. ] As provided in the Indenture and subject to certain limitations therein set forth, Securities of this series are exchangeable for a like aggregate principal amount of Securities of this series and of like tenor of a different authorized denomination as requested by the Holder surrendering the same.

No service charge shall be made for any such registration of transfer or exchange, but the Company may require payment of a sum sufficient to cover any tax or other governmental charge payable in connection therewith.

[ *If this Security is a Registered Security, insert X* Prior to due presentment of this Security for registration of transfer, the Company, the Trustee and any agent of the Company or the Trustee may treat the Person in whose name this Security is registered as the owner hereof for all purposes, whether or not this Security be overdue, and neither the Company, the Trustee nor any such agent shall be affected by notice to the contrary. ]

When a successor assumes all the obligations of its predecessor under the Securities of this series and the Indenture in accordance with the terms of the Indenture, the predecessor will be released from those obligations.

The Trustee under the Indenture, in its individual or any other capacity, may become the owner or pledgee of Securities of this series and may otherwise deal with the Company, its Subsidiaries or their respective Affiliates as if it were not the Trustee.

No stockholder, director, officer, employee, incorporator or Affiliate of the Company shall have any liability for any obligation of the Company under the Securities of this series or the Indenture or for any claim based on, in respect of or by reason of, such obligations or their creation. Each Holder of the Securities of this series, by accepting a Security of this series, waives and releases all such liability. The waiver and release are part of the consideration for the issuance of the Securities of this series.

This Security shall not be valid until the Trustee or Authenticating Agent signs the certificate of authentication on this Security.

[ Customary abbreviations may be used in the name of a Holder of a Registered Security of this series or an assignee, such as: TEN COM (= tenants in common), TEN ENT (= tenants by the entireties), JT TEN (= joint tenants with right of survivorship and not as tenants in common), CUST (= Custodian), and U/G/M/A (= Uniform Gifts to Minors Act). ]

Pursuant to a recommendation promulgated by the Committee on Uniform Security Identification Procedures, the Company will cause CUSIP numbers to be printed on the Securities of this series as a convenience to the Holders of the Securities of this series. No representation is made as to the accuracy of such numbers as printed on the Securities of this series and reliance may be placed only on the other identification numbers printed hereon.

**This Security shall be governed by and construed in accordance with the laws of the State of New York.**

All terms used in this Security that are defined in the Indenture shall have the meanings assigned to them in the Indenture.

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## ASSIGNMENT FORM

To assign this Security, fill in the form below:

I or we assign and transfer this Security to

(Print or type assignee's name, address and zip code)

(Insert assignee's soc. sec. or tax I.D. No.)

and irrevocably appoint him, her or it as agent to transfer this Security on the books of the Company. The agent may substitute another act for him, her or it.

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Date: \_\_\_\_\_

Your Signature: \_\_\_\_\_

Signature Guarantee: \_\_\_\_\_  
(Signature must be guaranteed)

\_\_\_\_\_ sign exactly as your name appears on the other side of this Security.

The signature(s) should be guaranteed by an eligible guarantor institution (banks, stockbrokers, savings and loan associations and credit unions with membership in the Securities Transfer Agents Medallion Program ("STAMP") or such other signature guarantee medallion program as may be approved by the Registrar in addition to or substitution for, STAMP), pursuant to S.E.C. Rule 17Ad-15.

[ In connection with any transfer or exchange of any of the Securities evidenced by this certificate occurring prior to the date that is two years after the later of the date of original issuance of such Securities and the last date, if any, on which such Securities were owned by the Company or any Affiliate of the Company, the undersigned confirms that such Securities are being:

CHECK ONE BOX BELOW:

- 1  acquired for the undersigned's own account, without transfer;
- 2  transferred to the Company;
- 3  transferred pursuant to and in compliance with Rule 144A under the Securities Act of 1933;
- 4  transferred pursuant to an effective registration statement under the Securities Act;
- 5  transferred pursuant to and in connection with Regulation S under the Securities Act of 1933; or
- 6  transferred pursuant to another available exemption from the registration requirements of the Securities Act of 1933.

Unless one of the boxes is checked, the Trustee may refuse to register any of the Securities evidenced by this certificate in the name of any person other than the registered holder thereof; *provided, however*, that if box (5) or (6) is checked, the Trustee or the Company may require, prior to registering any such transfer of the Securities, in their sole discretion, such legal opinions, certifications and other information as the Trustee or the Company may reasonably request to confirm that such transfer is being made pursuant to an exemption from, in a transaction not subject to, the registration requirements of the Securities Act of 1933, such as the exemption provided by Rule 144 under such Act.

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Signature

Signature Guarantee:

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(Signature must be guaranteed)

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Signature

The signature(s) should be guaranteed by an eligible guarantor institution (banks, stockbrokers, savings and loan associations and credit unions) with membership in the Securities Transfer Agents Medallion Program (“*STAMP*”) or such other signature guarantee medallion program as may be approved by the Security Registrar in addition to or substitution for *STAMP*, pursuant to S.E.C. Rule 17Ad-15. ]\*

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\* Include only for the original Global Securities

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[ TO BE ATTACHED TO GLOBAL SECURITIES ]

SCHEDULE OF INCREASES OR DECREASES IN GLOBAL SECURITIES

The following increases or decreases in this Global Security have been made:

Date of Exchange	Amount of decrease in Principal Amount of this Global Security	Amount of increase in Principal Amount of this Global Security	Principal Amount of this Global Security following such decrease or increase	Signature of authorized signatory of Trustee or Security Custodian
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[ THE FOLLOWING PROVISION TO BE INCLUDED  
ON ALL 144A CERTIFICATES ]

In connection with any transfer of this Security occurring prior to [ \_\_\_\_\_ ], the undersigned confirms that without utilizing any general solicitation or general advertising that:

[ Check One ]

- Γ (a) this Security is being transferred in compliance with the exemption from registration under the Securities Act of 1933, as amended, provided by Rule 144A thereunder.
- Γ (b) this Security is being transferred other than in accordance with (a) above and documents are being furnished that comply with the conditions of transfer set forth in this Security and the Indenture.

If neither of the foregoing boxes is checked, the Trustee or other Registrar shall not be obligated to register this Security in the name of any Person other than the Holder hereof unless and until the conditions to any such transfer of registration set forth herein and in Section [ 307 ] of the Indenture shall have been satisfied.

Date: \_\_\_\_\_  
NOTICE: The signature must correspond with the name as written upon the face of the within-mentioned instrument in every particular, without alteration or any change whatsoever.

Signature Guarantee: \_\_\_\_\_

TO BE COMPLETED BY PURCHASER IF (a) ABOVE IS CHECKED.

The undersigned represents and warrants that it is purchasing this Security for its own account or an account with respect to which it exercises sole investment discretion and that it and any such account is a "qualified institutional buyer" within the meaning of Rule 144A under the Securities Act of 1933, as amended, and is aware that the sale to it is being made in reliance on Rule 144A and acknowledges that it has received such information regarding the Company as the undersigned has requested pursuant to Rule 144A or has determined not to request such information and that it is aware that the transferor is relying upon the undersigned's foregoing representations in order to claim the exemption from registration provided by Rule 144A.

Date: \_\_\_\_\_  
NOTICE: To be executed by an executive officer.

SECTION 204. Form of Trustee's Certificate of Authentication

This is one of the Securities of the series designated herein and referred to in the within-mentioned Indenture.

Date: [ \_\_\_\_\_ ]

BANKERS TRUST COMPANY  
as Trustee

By: \_\_\_\_\_  
Authorized Signatory

SECTION 205. Form of Trustee's Certificate of Authentication by an Authenticating Agent

If at any time there shall be an Authenticating Agent provided with respect to any series of Securities, then the Trustee's Certificate of Authentication by such Authenticating Agent to be borne by the Securities of each such series shall be substantially as follows:

TRUSTEE'S CERTIFICATE OF AUTHENTICATION

This is one of the Securities of the series designated herein and referred to in the within-mentioned Indenture.

Date: [ \_\_\_\_\_ ]

BANKERS TRUST COMPANY  
as Trustee

By: [ NAME OF AUTHENTICATING AGENT ]

Authorized Signatory

By: \_\_\_\_\_  
Authorized Signatory

SECTION 206. Form of Regulation S Certificate

[ date on or after Release Date ]

Bankers Trust Company, as Trustee  
[ Four Albany Street  
New York, New York, 10006 ]  
Attention: [ Corporate Trust Agency Group – Public Utilities Group ]

Re: WPD Holdings UK  
[ Title of Security ] (the “ Notes ”)  
[ CUSIP No. \_\_\_\_\_ ] [ ISIN No. \_\_\_\_\_ ]

Ladies and Gentlemen:

Reference is hereby made to the Indenture, dated as of March [ \_\_\_ ], 2001 (the “ Indenture ”), between the Company, Bankers Trust Company, as Trustee, and Deutsche Bank Luxembourg S.A., as Paying Agent. Capitalized terms used herein and not otherwise defined have the meanings set forth in the Indenture.

[ For purposes of acquiring a beneficial interest in the Regulation S Permanent Global Security upon the expiration of the Restricted Period ] [ For purposes of receiving payments under the Regulation S Temporary Global Security ], the undersigned holder of a beneficial interest in the Regulation S Temporary Global Security issued under the Indenture certifies that it is not a U.S. person as defined by Regulation S under the Securities Act of 1933, as amended.

We understand that this certificate is required in connection with certain securities laws of the United States. In connection therewith, if administrative or legal proceedings are commenced or threatened in connection with which this certificate is or would be relevant, we irrevocably authorize you to produce this certificate to any interested party in such proceedings.

Yours truly,

[ Name of Holder ]

By: \_\_\_\_\_  
Authorized Signatory

**ARTICLE III**

**THE SECURITIES**

SECTION 301. Amount Unlimited; Issuable in Series

The aggregate principal amount of Securities that may be authenticated and delivered under this Indenture is unlimited.

The Securities may be issued in one or more series. There shall be established in or pursuant to a Board Resolution and, subject to Section 303, set forth or determined in the manner provided in an Officers’ Certificate, or established in one or more indentures supplemental hereto, prior to the issuance of Securities of any series:

- (i) the title of the Securities of the series (which shall distinguish the Securities of the series from all other Securities);
- (ii) any limit upon the aggregate principal amount of the Securities of the series that may be authenticated and delivered under this Indenture (except for Securities authenticated and delivered upon registration of transfer of, or in exchange for, or in lieu of, other Securities of the series pursuant to Sections 305, 306, 307 or 906, and except for any Securities that, pursuant to Section 303, are deemed never to have been authenticated and delivered hereunder);

- (iii) the Person to whom any interest on a Security of the series shall be payable, if other than the bearer (in the case of a Global Bearer Security) or the Person in whose name the Security (or one or more Predecessor Securities) is registered at the close of business on the Regular Record Date for such interest (in the case of a Registered Security);
- (iv) the date or dates on which the principal of the Securities of the series is payable;
- (v) the rate or rates at which the Securities of the series shall bear interest, if any, the date or dates from which such interest shall accrue, the Interest Payment Dates on which such interest shall be payable, and the Regular Record Date for the interest payable on any Interest Payment Date;
- (vi) the place or places, if any, in addition to or in the place of the Corporate Trust Office, where the principal of (and premium, if any) and interest, if any, on Securities of the series shall be payable and (in the case of the Registered Securities) where such Securities may be registered or transferred;
- (vii) the period or periods within which, the price or prices at which, and the terms and conditions upon which, Securities of the series may be redeemed, in whole or in part, at the option of the Company;
- (viii) the obligation, if any, of the Company to redeem, repay or repurchase Securities of the series pursuant to any sinking fund or analogous provisions or at the option of a Holder thereof, and the period or periods within which, the price or prices at which, and the terms and conditions upon which, Securities of the series shall be redeemed, repaid or repurchased, in whole or in part, pursuant to such obligation;
- (ix) if other than denominations of \$1,000 and any integral multiple thereof, the denominations in which Securities of the series shall be issuable;
- (x) if other than the principal amount thereof, the portion of the principal amount of Securities of the series which shall be payable upon declaration of acceleration of the Maturity thereof pursuant to Section 502;
- (xi) if other than such coin or currency of the United States of America as at the time of payment is legal tender for payment of public or private debts, the coin or currency in which payment of the principal of (and premium, if any) and interest, if any, on the Securities of the series shall be payable;
- (xii) if the principal of (and premium, if any) or interest, if any, on the Securities of the series are to be payable, at the election of the Company or a Holder thereof, in a coin or currency other than that in which the Securities are stated to be payable, the period or periods within which, and the terms and conditions upon which, such election may be made;
- (xiii) if the amount of payments of principal of (and premium, if any) or interest, if any, on the Securities of the series may be determined with reference to an index based on a coin or currency other than that in which the Securities are stated to be payable, the manner in which such amounts shall be determined;
- (xiv) any provisions permitted by this Indenture relating to Events of Default or covenants of the Company with respect to such series of Securities;
- (xv) if the Securities of the series shall be issued in whole or in part in the form of one or more Global Securities, (i) whether beneficial owners of interests in any such Global Security may exchange such interests for Securities of such series of like tenor and of authorized form and denomination and the circumstances under which any such changes may occur, if other than in the manner provided in Section 306, and (ii) the Book-Entry Depository for such Global Security or Securities;
- (xvi) if the Company ever wishes to issue definitive Bearer Securities, then all provisions relating to or governing such Bearer Securities will be set forth in an indenture supplemental hereto; and
- (xvii) any other terms of the series (which terms shall not be inconsistent with the provisions of this Indenture).

All Securities of any one series shall be substantially identical, except as to denomination and except as may otherwise be provided in or pursuant to the Board Resolution referred to above and set forth in the Officers' Certificate referred to above, or in any indenture supplemental hereto referred to above.

If any of the terms of the Securities of a series, including the form of Security of such series, are established by action taken pursuant to a Board Resolution, a copy of an appropriate record of such action shall be certified by the Secretary or an Assistant Secretary or other authorized officer or Director of the Company, and delivered to the Trustee at or prior to the delivery of the Company Order contemplated by Section 303 for the authentication and delivery of such series of Securities.

#### SECTION 302. Denominations

The Securities of each series shall be issuable in bearer form or in registered form without coupons, except as otherwise expressly provided in a supplemental indenture hereto, in such denominations as shall be specified as contemplated by Section 301. In the absence of any such provisions with respect to the Securities of any series, the Securities of such series shall be issuable in denominations of



\$1,000 and any integral multiple thereof.

SECTION 303. Execution, Authentication, Delivery and Dating

Any Director, the Secretary or any other officer of the Company so authorized shall execute the Securities on behalf of the Company and need not be attested. Definitive Registered Securities of any series may have the Company's seal reproduced thereon and need not be attested. Such additional Director or officer, if any, as shall be specified pursuant to Section 301 shall execute the Securities of any series. The signature of any of these officers on the Securities may be manual or facsimile.

Securities bearing the manual or facsimile signature of any individual who was at any time the proper Director or officer of the Company shall bind the Company, notwithstanding that such individual has ceased to hold such office prior to the authentication and delivery of such Securities or did not hold such office at the date of authentication of such Securities.

At any time and from time to time after the execution and delivery of this Indenture, the Company may deliver Securities of any series executed by the Company to the Trustee for authentication, together with a Company Order for the authentication and delivery of such Securities, and the Trustee in accordance with the Company Order shall authenticate and deliver such Securities. If the form of terms of the Securities of the series have been established in or pursuant to one or more Board Resolutions as permitted by Sections 201 and 301, in authenticating such Securities, and accepting the additional responsibilities under this Indenture in relation to such Securities, the Trustee shall be entitled to receive, and (subject to Section 601) shall be fully protected in relying upon, an Opinion of Counsel stating:

- (i) if the form of such Securities has been established by or pursuant to Board Resolution as permitted by Section 201, that such form has been established in conformity with the provisions of this Indenture;
- (ii) if the terms of such Securities have been established by or pursuant to Board Resolution as permitted by Section 301, that such terms have been established in conformity with the provisions of this Indenture; and
- (iii) that such Securities, when authenticated and delivered by the Trustee and issued by the Company in the manner and subject to any conditions specified in such opinion of Counsel, will constitute valid and legally binding obligations of the Company, enforceable in accordance with their terms, subject to bankruptcy, insolvency, reorganization, and other laws of general applicability relating to or affecting the enforcement of creditors' rights and to general principles of equity.

Notwithstanding the provisions of Section 301 and of the preceding paragraph, if all Securities of a series are not to be originally issued at one time, it shall not be necessary to deliver the Officers' Certificate otherwise required pursuant to Section 301 or the Company Order and Opinion of Counsel otherwise required pursuant to such preceding paragraph at or prior to the time of authentication of each Security of such series if such documents are delivered at or prior to the time of authentication upon original issuance of the first Security of such series to be issued.

Each Security shall be dated the date of its authentication.

No Security shall be entitled to any benefit under this Indenture or be valid or obligatory for any purpose unless there appears on such Security a certificate of authentication, substantially in the form provided for herein, executed by the Trustee or an Authenticating Agent by manual signature, and such certificate upon any Security shall be conclusive evidence, and the only evidence, that such Security has been duly authenticated and delivered hereunder and is entitled to the benefits of this Indenture. Notwithstanding the foregoing, if any Security shall have been authenticated and delivered hereunder but never issued and sold by the Company, and the Company shall deliver such Security to the Trustee for cancellation as provided in Section 310 together with a written statement (which need not be accompanied by an Opinion of Counsel) stating that such Security has never been issued and sold by the Company, for all purposes of this Indenture such Security shall be deemed never to have been authenticated and delivered hereunder and shall never be entitled to the benefits of this Indenture.

In case the Company, pursuant to Article VIII, shall be consolidated or merged with or into any other Person or shall convey, transfer, lease or otherwise dispose of its properties and assets substantially as an entirety to any Person, and the successor Person resulting from such consolidation, or surviving such merger, or into which the Company shall have been merged, or the Person which shall have received a conveyance, transfer, lease or other disposition as aforesaid, shall have executed an Indenture supplemental hereto with the Trustee pursuant to Article VIII, any of the Securities authenticated or delivered prior to such consolidation, merger, conveyance, transfer, lease or other disposition may, from time to time, at the request of the successor Person, be exchanged for other Securities executed in the name of the successor Person with such changes in phraseology and form as may be appropriate, but otherwise in substance of like tenor as the Securities surrendered for such exchange and of like principal amount; and the Trustee, upon Company Request of the successor Person, shall authenticate and deliver Securities as specified in such request for the purpose of such exchange. If Securities shall at any time be authenticated and delivered in any new name of a successor Person pursuant to this Section 303 in exchange or substitution for or upon registration of transfer of any Securities, such successor Person, at the option of the Holders but without expense to them, shall provide for the exchange of all Securities at the time Outstanding for Securities authenticated and delivered in such new name.

SECTION 304. Transfer Agent and Paying Agent

For so long as the Securities are listed on the Luxembourg Stock Exchange and such stock exchange shall so require, the Company shall maintain a Paying Agent and Transfer Agent in Luxembourg.

The Company shall enter into an appropriate agency agreement with any Registrar, Transfer Agent or Paying Agent not a party to this Indenture, which shall implement the provisions of this Indenture that relate to such Person. The Company shall notify the Trustee

of the name and address of any such Person. If the Company fails to maintain a Registrar or Paying Agent, the Trustee shall act as such and shall be entitled to appropriate compensation therefor pursuant to Section 607. The Company initially appoints the Trustee as Registrar, Transfer Agent and Principal Paying Agent in The City of New York and Deutsche Bank Luxembourg S.A. as Paying Agent and Transfer Agent in Luxembourg in connection with the Securities.

#### SECTION 305. Temporary Securities

Pending the preparation of a permanent Global Security or definitive Securities of any series, the Company may execute, and upon Company Order the Trustee or the Authenticating Agent shall authenticate and deliver, temporary Securities that are printed, lithographed, typewritten, mimeographed or otherwise produced, in any authorized denomination, substantially of the tenor of the definitive Securities in lieu of which they are issued, in registered form or, if authorized, in bearer form, and with such appropriate insertions, omissions, substitutions and other variations as the Director(s) or officer(s) executing such Securities may determine, as evidenced by their execution of such Securities.

If temporary Securities of any series are issued, the Company will cause definitive Securities of that series to be prepared without unreasonable delay. After the preparation of definitive Securities of such series, the temporary Securities of such series shall be exchangeable for definitive Securities of such series upon surrender of the temporary securities of such series at the office or agency of the Company in a Place of Payment for that series, without charge to the Holder except as provided in Section 306 in connection with a transfer, and except that a Person receiving definitive Bearer Securities shall bear the cost of insurance, postage, transportation, and the like. Upon surrender for cancellation of any one or more temporary Securities of any series, the Company shall execute and the Trustee or the Authenticating Agent shall authenticate and deliver in exchange thereof a like principal amount of definitive Securities of the same series and of like tenor of authorized denominations. Until so exchanged, the temporary Securities shall in all respects be entitled to the same benefits under this Indenture as definitive Securities.

Upon any exchange of a portion of a temporary Global Security for a definitive Global Security for the individual Securities represented thereby pursuant to this Section 305 or Section 306, the temporary Global Security shall be endorsed by the Trustee to reflect the reduction of the principal amount of such temporary Global Security, and such principal amount shall be reduced for all purposes by the amount so exchanged and endorsed.

#### SECTION 306. Registration, Registration of Transfer and Exchange

The Company shall cause to be kept at the Corporate Trust Office of the Trustee a register (the register maintained in such office and in any other office or agency of the Company in a Place of Payment being herein sometimes collectively referred to as the "*Security Register*") in which, subject to such reasonable regulations as it may prescribe, the Company shall provide for the registration of Registered Securities and of transfers of Registered Securities. The Trustee is hereby appointed "*Security Registrar*" for the purpose of registering Registered Securities and transfers of Registered Securities as herein provided. The Company may have one or more co-registrars and the term "*Security Registrar*" includes any co-registrar.

Upon surrender for registration of transfer of any Registered Security of any series at the office or agency in a Place of Payment for that series, the Company shall execute, and the Trustee or the Authenticating Agent shall authenticate and deliver, in the name of the designated transferee or transferees, one or more new Registered Securities of the same series, of any authorized denominations and of a like aggregate principal amount and tenor.

Furthermore, each Holder of a Global Security shall, by acceptance of such Global Security, agree that transfers of beneficial interest in such Global Security may be effected only through a book-entry system maintained by the Holder of such Global Security (or its agent), and that ownership of a beneficial interest in the Global Security shall be required to be reflected in a book-entry.

At the option of the Holder, any Registered Security or Registered Securities of any series, other than a Global Security, may be exchanged for other Registered Securities of the same series, of any authorized denominations and of a like aggregate principal amount and tenor, upon surrender of the Registered Securities to be exchanged at such office or agency. Whenever any Securities are so surrendered for exchange, the Company shall execute, and upon receipt of a Company Order the Trustee or the Authenticating Agent shall authenticate and deliver, the Registered Securities that the Holder making the exchange is entitled to receive. None of the Trustee, the Authenticating Agent or the Security Registrar may deliver Bearer Securities in exchange for Registered Securities.

All Securities issued upon any registration of transfer or exchange of Registered Securities shall be the valid obligations of the Company, evidencing the same debt, and entitled to the same benefits under this Indenture, as the Registered Securities surrendered upon such registration of transfer or exchange.

Every Registered Security presented or surrendered for registration of transfer or for exchange shall (if so required by the Company or the Trustee) be duly endorsed, or be accompanied by a written instrument of transfer in form satisfactory to the Company and the Security Registrar duly executed, by the Holder thereof or his attorney duly authorized in writing.

Upon the exchange in whole of a Global Security for the definitive Securities represented thereby, such Global Security shall be canceled by the Trustee or delivered to the Trustee for cancellation. Registered Securities issued in exchange for a Global Security or any portion thereof pursuant to this Section shall be registered in such names and in such authorized denominations as the Book-Entry Depository for such Global Security shall instruct in writing the Trustee and the Security Registrar. The Trustee or the Security Registrar shall deliver such Registered Securities to the Persons in whose names such Registered Securities are so registered.

Interests in a Permanent Global Security may be exchanged for definitive Registered Securities of the same series only under the circumstances provided in this Indenture or in an indenture supplemental hereto pursuant to which Securities of that series are issued or in the Securities of that Series. In such event the Company will execute, and the Trustee or the Authenticating Agent, upon receipt of a Company Order for the authentication and delivery of definitive Registered Securities of such series, will authenticate and deliver such definitive Registered Securities. Any such definitive Registered Securities so issued shall be registered in the name of such Person or Persons as the Book-Entry Depository shall instruct the Trustee and the Security Registrar in writing. Upon the exchange in whole of a Permanent Global Security for definitive Registered Securities in equal aggregate principal amount, such Permanent Global Security shall be delivered to the Trustee for cancellation. Interests in a Permanent Global Security may not be exchanged for definitive Bearer Securities. Notwithstanding the foregoing, interests in a Global Security may not be exchanged for definitive Registered Securities during the 16-day period immediately prior to and including each Interest Payment Date.

No service charge shall be made to the Holder for any registration of transfer or exchange of Securities, but the Company may require payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in connection with any registration of transfer or exchange of Securities, other than exchanges pursuant to Sections 305, 906 or 1107 not involving any transfer.

The Company shall not be required (i) to issue, register the transfer of or exchange Securities of any series during a period beginning at the opening of business 15 days before the day of the mailing of a notice of redemption under Section 1104 and ending at the close of business on the day of such mailing, (ii) to register the transfer of or exchange any Security so selected for redemption in whole or in part, except the unredeemed portion of any Security being redeemed in part, or (iii) to exchange any Bearer Security so selected for redemption, except that such a Bearer Security may be exchanged for a Registered Security of the series (but only if and under the circumstances for which the Securities of such series are issuable as Registered Securities); *provided* that such Registered Security shall be immediately surrendered for redemption with written instructions for payment consistent with the provisions of this Indenture.

The provisions of this Section 306 are, with respect to any Global Security, subject to Section 312 hereof.

#### SECTION 307. Mutilated, Destroyed, Lost and Stolen Securities

If any mutilated Security is surrendered to the Trustee, the Company shall execute and the Trustee shall authenticate and deliver in exchange thereof a new Security of the same series and of like tenor and principal amount and bearing a number not contemporaneously outstanding.

If there shall be delivered to the Company and the Trustee (i) evidence to their satisfaction of the destruction, loss or theft of any Security and (ii) such security or indemnity as may be required by them to save each of them and any agent of either of them harmless, then, in the absence of notice to the Company or the Trustee that such Security has been acquired by a bona fide purchaser, the Company shall execute and upon its written request the Trustee shall authenticate and deliver, in lieu of any such destroyed, lost or stolen Security, a new security of the same series and of like tenor and principal amount and bearing a number not contemporaneously outstanding.

In case any such mutilated, destroyed, lost or stolen Security has become or is about to become due and payable, the Company in its discretion may, instead of issuing a new Security, pay such Security.

Upon the issuance of any new Security under this Section 307, the Company may require the payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in relation thereto and any other expenses (including the fees and expenses of the Trustee) connected therewith.

Every new Security of any series issued pursuant to this Section 307 in lieu of any destroyed, lost or stolen Security shall constitute an original additional contractual obligation of the Company, whether or not the destroyed, lost or stolen Security shall be at any time enforceable by anyone, and shall be entitled to all the benefits of this Indenture equally and proportionately with any and all other Securities of that series duly issued hereunder.

The provisions of this Section 307 are exclusive and shall preclude (to the extent lawful) all other rights and remedies with respect to the replacement or payment of mutilated, destroyed, lost or stolen Securities.

#### SECTION 308. Payment of Interest; Interest Rights Reserved

Interest on any Security which is payable, and is punctually paid or duly provided for, on any Interest Payment Date shall be paid (i) in the case of a Bearer Security, to the bearer thereof, and (ii) in the case of a Registered Security, to the Person in whose name that Registered Security (or one or more Predecessor Securities) is registered at the close of business on the Regular Record Date for such interest.

Payment of interest, if any, in respect of any Registered Security will be made by check mailed to the address of the Person entitled thereto as such Person's address appears in the Security Register. Payment of interest, if any, in respect of any Registered Security may also be made, in the case of a Holder of at least U.S. \$1,000,000 aggregate principal amount of Registered Securities, and payment of interest, if any, in respect of a Permanent Global Security shall be made, by wire transfer to a U.S. Dollar account maintained by the Holder with a bank in the United States; *provided* that such Holder elects payment by wire transfer by giving written notice to the Trustee or a Paying Agent to such effect designating such account no later than 15 days immediately preceding the relevant due date for payment (or such other date as the Trustee may accept in its discretion).

Any interest on any Security of any series which is payable but is not punctually paid or duly provided for on any Interest Payment Date (herein called "*Defaulted Interest*") shall, in the case of Registered Securities, forthwith cease to be payable to the Holder

thereof on the relevant Regular Record Date by virtue of having been such Holder, and such Defaulted Interest may be paid by the Company, at its election in each case, as provided in Clause (i) or (ii) below:

- (i) The Company may elect to make payment of any Defaulted Interest to the Persons in whose names the Registered Securities of such series (or their respective Predecessor Securities) are registered at the close of business on a Special Record Date for the payment of such Defaulted Interest, which shall be fixed in the following manner. The Company shall notify the Trustee in writing of the amount of Defaulted Interest proposed to be paid on each Registered Security of such series and the date of the proposed payment, and at the same time the Company shall deposit with the Trustee an amount of money equal to the aggregate amount proposed to be paid in respect of such Defaulted Interest or shall make arrangements satisfactory to the Trustee for such deposit prior to the date of the proposed payment, such money when deposited to be held in trust for the benefit of the Persons entitled to such Defaulted Interest as in this clause provided. Thereupon the Trustee shall fix a Special Record Date for the payment of such Defaulted Interest which shall be not more than 15 days and not less than 10 days prior to the date of the proposed payment, and not less than 10 days after the receipt by the Trustee of the notice of the proposed payment. Unless the Trustee is acting as the Security Registrar, promptly after such Special Record Date, the Company shall furnish the Trustee with a list, or shall make arrangements satisfactory to the Trustee with respect thereto, of the names and addresses of, and respective principal amounts of such Registered Securities held by, the Holders appearing on the Security Register at the close of business on such Special Record Date. The Trustee shall promptly notify the Company of such Special Record Date and, in the name and at the expense of the Company, shall cause notice of the proposed payment of such Defaulted Interest and the Special Record Date therefor to be mailed, first-class postage prepaid, to each Holder of Securities of such series at his address as it appears in the Security Register, not less than 10 days prior to such Special Record Date. Notice of the proposed payment of such Defaulted Interest and the Special Record Date therefor having been so mailed, such Defaulted Interest shall be paid to the Persons in whose names the Securities of such series (or their respective Predecessor Securities) are registered at the close of business on such Special Record Date and shall no longer be payable pursuant to the following clause (ii).
- (ii) The Company may make payment of any Defaulted Interest on the Registered Securities of any series of any Permanent Global Security in any other lawful manner not inconsistent with the requirements of any securities exchange on which such Registered Securities may be listed, and upon such notice as may be required by such exchange.

Defaulted Interest on Global Bearer Securities shall be payable to the bearer thereof at the time of payment of such Defaulted Interest by the Company.

Subject to the foregoing provisions of this Section 308, each Security delivered under this Indenture upon registration of transfer of or in exchange for or in lieu of any other Security, shall carry the rights to interest accrued and unpaid, and to accrue, which were carried by such other Security.

#### SECTION 309. Persons Deemed Owners

Prior to due presentment of a Registered Security for registration of transfer, the Company, the Trustee and any agent of the Company or the Trustee may treat the Person in whose name such Registered Security is registered as the owner of such Registered Security for the purpose of receiving payment of principal of (and premium, if any) and (subject to Section 308) interest, if any, on such Registered Security and for all other purposes whatsoever, whether or not such Registered Security be overdue, and neither the Company, the Trustee nor any agent of the Company or the Trustee shall be affected by notice to the contrary. All such payments so made to any such person, or upon such person's order, shall be valid, and, to the extent of the sums so paid, effectual to satisfy and discharge the liability for monies payable upon any such Security.

The Company, the Trustee, and any agent of the Company or the Trustee may treat the Book-Entry Depository for a Global Bearer Security as the absolute owner of such Bearer Security for the purpose of receiving payment thereof or on account thereof and for all other purposes whatsoever, whether or not such Global Bearer Security or coupon be overdue, and neither the Company, the Trustee nor any agent of the Company or the Trustee shall be affected by notice to the contrary.

No holder of any beneficial interest in any Global Security held on its behalf by a Book-Entry Depository shall have any rights under this Indenture with respect to such Global Security, and such Book-Entry Depository may be treated by the Company, the Trustee, and any agent of the Company or the Trustee as the owner of such Global Security for all purposes whatsoever. Notwithstanding the foregoing, nothing herein shall impair, as between a Book-Entry Depository and such holders of beneficial interests, the operation of customary practices governing the exercise of the rights of the Book-Entry Depository as holder of any Security.

#### SECTION 310. Cancellation

All Securities surrendered for payment, redemption, registration of transfer or exchange or for credit against any sinking fund payment shall, if surrendered to any Person other than the Trustee, be delivered to the Trustee and shall be promptly canceled by it. The Company may at any time deliver to the Trustee for cancellation any Securities previously authenticated and delivered hereunder that the Company may have acquired in any manner whatsoever, and the Trustee shall promptly cancel all Securities so delivered. No Securities shall be authenticated in lieu of or in exchange for any Securities canceled as provided in this Section 310, except as expressly permitted by this Indenture. All canceled Securities held by the Trustee shall be disposed of as directed by a Company Order.

#### SECTION 311. Computation of Interest

Except as otherwise specified as contemplated by Section 301 for Securities of any series, interest, if any, on the Securities of each series shall be computed on the basis of a 360-day year of twelve 30-day months.

SECTION 312. Global Securities

(a) If the Company shall establish pursuant to Section 301 that the Securities of a particular series are to be issued in the form of a Global Security, then the Company shall execute and the Trustee shall, in accordance with Section 303, authenticate and deliver, a Global Security or Securities that (i) shall represent, and shall be denominated in an aggregate amount equal to the aggregate principal amount of, all of the Outstanding Securities of such series, (ii) shall be in bearer form or, if in registered form, registered in the name of the Book-Entry Depository or its nominee, (iii) shall be delivered by the Trustee to the Book-Entry Depository or pursuant to the Book-Entry Depository's instruction, and (iv) shall bear the legends set forth in Section 202, as applicable.

(b) Participants in DTC shall have no rights under this Indenture with respect to any Global Securities held on their behalf by DTC, or the Trustee as its custodian, or the Book-Entry Depository, or under the Global Security, and DTC, as the case may be, or the Book-Entry Depository, may be treated by the Company, the Trustee, and any agent of the Company or the Trustee as the absolute owner of such Global Security for all purposes whatsoever. Notwithstanding the foregoing, nothing herein shall prevent the Company, the Trustee or any agent of the Company or the Trustee from giving effect to any written certification, proxy or other authorization furnished by DTC or shall impair, as between DTC and its Participants, the operation of customary practices governing the exercise of the rights of a Holder of any Security.

(c) Notwithstanding the provisions of Section 306, the Global Security of a series may be transferred, in whole but not in part and in the manner provided in Section 306, only to another nominee of the Book-Entry Depository for such series, or to a successor Book-Entry Depository for such series selected or approved by the Company or to a nominee of such successor Book-Entry Depository. Interests of beneficial owners in Global Securities may be transferred in accordance with the rules and procedures of DTC and the provisions of Section 313.

(d) The circumstances, if any, under which the Global Security of a series may be exchanged for definitive Registered Securities of such series shall be as specified in an indenture supplemental hereto pursuant to which the Securities of such series are issued. In such event, the Company will execute, and, subject to Section 306, the Trustee, upon receipt of an Officers' Certificate evidencing such determination by the Company, will authenticate and deliver Securities of such series in definitive registered form without coupons, in authorized denominations, and in an aggregate principal amount equal to the principal amount of the Global Securities of such series in exchange for such Global Securities. Upon the exchange of the Global Securities for such Securities in definitive registered form without coupons, in authorized denominations, the Trustee shall cancel the Global Securities. Such securities in definitive registered form issued in exchange for the Global Securities pursuant to this Section 312, shall be registered in such names and in such authorized denominations as the Book-Entry Depository, pursuant to the instructions from its direct or indirect participants or otherwise, shall instruct the Trustee. The Trustee shall deliver Securities to the Book-Entry Depository for delivery to the persons in whose names such Securities are so registered.

(e) No Security that is not a Global Security may be payable to bearer (except as otherwise provided in an indenture supplemental hereto pursuant to Section 301(xvi)).

(f) The Holder of a Global Security may grant proxies and otherwise authorize any person, including Participants and Persons that may hold interest through Participants, to take any action which a Holder is entitled to take under this Indenture or the Securities.

SECTION 313. Special Transfer Provisions

(a) Prior to the expiration of the Resale Restriction Termination Date, a transfer of a Rule 144A Security or a beneficial interest therein to a QIB shall be made upon the representation of the transferee that it is purchasing the Security for its own account or an account with respect to which it exercises sole investment discretion and that it and any such account is a "qualified institutional buyer" within the meaning of Rule 144A under the Securities Act and is aware that the sale to it is being made in reliance on Rule 144A and acknowledges that it has received such information regarding the Company as the undersigned has requested pursuant to Rule 144A or has determined not to request such information and that it is aware that the transferor is relying upon its foregoing representations in order to claim the exemption from registration provided by Rule 144A.

A transfer of a Rule 144A Security or a beneficial interest therein to a Non-U.S. Person shall be made upon receipt by the Trustee or its agent of a certificate substantially in the form set forth in Section 314 hereof from the proposed transferee and, if requested by the Company or the Trustee, the delivery of an opinion of counsel, certification and/or other information satisfactory to each of them.

(b) The following provisions shall apply with respect to any proposed transfer of a Regulation S Security prior to the expiration of the Restricted Period:

- (i) a transfer of a Regulation S Security or a beneficial interest therein to a QIB shall be made upon the representation of the transferee that it is purchasing the Security for its own account or an account with respect to which it exercises sole investment discretion and that it and any such account is a "qualified institutional buyer" within the meaning of Rule 144A under the Securities Act and is aware that the sale to it is being made in reliance on Rule 144A and acknowledges that it has received such information regarding the Company as the undersigned has requested pursuant to Rule 144A or has determined not to request such information and that it is aware that the transferor is relying upon its foregoing representations in order to claim the exemption from registration provided by Rule 144A; and

- (ii) a transfer of a Regulation S Security or a beneficial interest therein to a Non-U.S. Person shall be made upon, if requested by the Company or the Trustee, receipt by the Trustee or its agent of an opinion of counsel, certification and/or other information satisfactory to each of them.

Prior to or on the expiration of the Restricted Period, beneficial interests in a Regulation S Global Security may only be held through Euroclear or Clearstream (as indirect participants in DTC) or another agent member of Euroclear and Clearstream acting for and on behalf of them, unless exchanged for interests in the Rule 144A Global Security in accordance with the certification requirements hereof. During the Restricted Period, interests in the Regulation S Global Security, if any, may be exchanged for interests in the Rule 144A Global Security or for definitive Securities only in accordance with the certification requirements described in Section 201.

After the expiration of the Restricted Period, interests in the Regulation S Security may be transferred without requiring certification.

(c) Upon the transfer, exchange or replacement of Securities not bearing a private placement legend, the Security Registrar shall deliver Securities that do not bear a private placement legend. Upon the transfer, exchange or replacement of Securities bearing a private placement legend, the Security Registrar shall deliver only Securities that bear the placement legend unless there is delivered to the Security Registrar an opinion of counsel reasonably satisfactory to the Company and the Trustee to the effect that neither such legend nor the related restrictions on transfer are required in order to maintain compliance with the provisions of the Securities Act.

(d) By its acceptance, of any Security bearing a private placement legend, each Holder of such a Security acknowledges the restrictions on transfer of such Security set forth in this Indenture and in the private placement legend and agrees that it will transfer such Security only as provided in this Indenture.

(e) The Company shall deliver to the Trustee an Officer's Certificate setting forth the dates on which the Restricted Period terminates (the "Resale Restriction Termination Date").

The Security Registrar shall retain copies of all letters, notices and other written communications received pursuant to this Article. The Company shall have the right to inspect and make copies of all such letters, notices or other written communications at any reasonable time upon the giving of reasonable written notice to the Security Registrar.

(f) The Trustee:

- (i) shall have no responsibility or obligation to any beneficial owner of a Global Security, a Participant in DTC or other Person with respect to any ownership interest in the Securities, with respect to the accuracy of the records of DTC or its nominee or of any Participant or member thereof or with respect to the delivery to any Participant, member, beneficial owner or other Person (other than DTC) of any notice (including any notice of redemption) or the payment of any amount, under or with respect to such Securities. All notices and communications to be given to the Holders and all payments to be made to Holders under the Securities shall be given or made only to the registered Holders (which shall be DTC or its nominee in the case of a Global Security). The rights of beneficial owners in any Global Security in global form shall be exercised only through DTC subject to the applicable rules and procedures of DTC. The Trustee may rely and shall be fully protected and indemnified pursuant to Section 607 in relying upon information furnished by DTC with respect to any beneficial owners, its members and participants; and
- (ii) the Trustee shall have no obligation or duty to monitor, determine or inquire as to compliance with any restrictions on transfer imposed under this Indenture or under applicable law with respect to any transfer of any interest in any Security (including without limitation any transfers between or among Participants, members or beneficial owners in any Global Security) other than to required deliver of such certificates and other documentation of evidence as are expressly required by, and to do so if an when expressly required by, the terms of this Indenture, and to examine the same to determine substantial compliance as to form with the express requirements hereof.

SECTION 314. Form of Certificate to Be Delivered in Connection with Transfers Pursuant to Regulation S

[ date ]

Bankers Trust Company, as Trustee  
Four Albany Street  
New York, New York, 10006  
Attention: Manager, Project Finance

Re: WPD Holdings UK (the "Company")  
[ Name of Security ] (the "Notes")

Ladies and Gentlemen:

In connection with our proposed sale of \$\_\_\_\_\_ aggregate principal amount of the Notes, we confirm that such sale has been effected pursuant to and in accordance with Regulation S under the United States Securities Act of 1933, as amended (the "Securities Act"), and, accordingly, we represent that:

- (a) the offer of the Notes was not made to a person in the United States;
- (b) either (i) at the time the buy order was originated, the transferee was outside the United States or we and any person acting on our behalf reasonably believed that the transferee was outside the United States or (ii) the transaction was executed in, on or through the facilities of a designated off-shore securities market and neither we nor any person acting on our behalf knows that the transaction has been pre-arranged with a buyer in the United States;
- (c) no directed selling efforts have been made in the United States in contravention of the requirements of Rule 903(b) or Rule 904(b) of Regulation S, as applicable; and
- (d) the transaction is not part of a plan or scheme to evade the registration requirements of the Securities Act.

In addition, if the sale is made during a restricted period and the provisions of Rule 903(c)(3) or Rule 904(c)(1) of Regulation S are applicable thereto, we confirm that such sale has been made in accordance with the applicable provisions of Rule 903(c)(3) or Rule 904(c)(1), as the case may be.

You and the Company are entitled to rely upon this letter and are irrevocably authorized to produce this letter or a copy hereof to any interested party in any administrative or legal proceedings or official inquiry with respect to the matters covered hereby. Terms used in this certificate have the meanings set forth in Regulation S.

Very truly yours,

[ Name of Transferor ]

By:

\_\_\_\_\_  
Authorized Signature

\_\_\_\_\_  
Signature Medallion Guaranteed

#### ARTICLE IV

#### SATISFACTION AND DISCHARGE

##### SECTION 401. Satisfaction and Discharge of Indenture

This Indenture shall upon Company Request cease to be of further effect (except as to any surviving rights of registration of transfer or exchange of Securities herein expressly provided for and rights to receive payments of any principal, premium or interest in respect thereof and any right to receive any Additional Amount as provided in Section 1009), and the Trustee shall execute proper instruments acknowledging satisfaction and discharge of this Indenture, when:

- (i) either:
  - (a) all Securities theretofore authenticated and delivered (other than (1) Securities that have been destroyed, lost or stolen and that have been replaced or paid as provided in Section 307 and (2) Securities for whose payment money has theretofore been deposited in trust with the trustee or any paying agent or segregated and held in trust by the Company and thereafter repaid to the Company or discharged from such trust, as provided in Section 1003) have been delivered to the Trustee for cancellation; or
  - (b) all such Securities not theretofore delivered to the Trustee for cancellation:
    - (1) have become due and payable,
    - (2) will become due and payable at their Stated Maturity within one year,
    - (3) are to be called for redemption within one year under arrangements for the giving of notice of redemption by the Trustee in the name, and at the expense, of the Company, or
    - (4) are deemed paid and discharged pursuant to Section 403, as applicable,

and the Company, in the case of (1) or (2) above, has deposited or caused to be deposited with the Trustee as trust funds, in trust for the purpose, an amount of (w) money in the currency or units of currency in which such Securities

are payable, (x) U.S. Government Obligations (denominated in the same currency or units of currency in which such Securities are payable) that through the payment of interest and principal in respect thereof in accordance with their terms will provide not later than one day before the Stated Maturity or Redemption Date, as the case may be, money in an amount, (y) a combination of money or U.S. Government Obligations as provided in (4) above, in each case, sufficient to pay and discharge the entire indebtedness on such Securities not theretofore delivered to the Trustee for cancellation, for principal (and premium, if any) and interest, if any, to the date of such deposit (in the case of Securities that have become due and payable) or to the Stated Maturity or Redemption Date, as the case may be;

- (ii) the Company has paid or caused to be paid all other sums payable hereunder by the Company; and
- (iii) the Company has delivered to the Trustee an Officers' Certificate and an Opinion of Counsel, each stating that all conditions precedent herein provided for relating to the satisfaction and discharge of this Indenture have been complied with.

Notwithstanding the satisfaction and discharge of this Indenture, the obligations of the Company to the Trustee under Section 607, the obligations of the Trustee to any Authenticating Agent under Section 614, and, if money shall have been deposited with the Trustee pursuant to sub-clause (b) of clause (i) of this Section 401 or if money or U.S. Government Obligations shall have been deposited with or received by the Trustee pursuant to Section 403, the obligations of the Trustee under Section 402 and the last paragraph of Section 1003 shall survive.

#### SECTION 402. Application of Trust Money

(a) Subject to the provisions of the last paragraph of Section 1003, all money or U.S. Government Obligations deposited with the Trustee pursuant to Sections 401 or 403, and all money received by the Trustee in respect of U.S. Government Obligations deposited with the Trustee pursuant to Sections 401 or 403, shall be held in trust and applied by it, in accordance with the provisions of the Securities and this Indenture, to the payment, to the Persons entitled thereto, of the principal of (and premium, if any) and interest, if any, on the Securities for whose payment such money has been deposited with or received by the Trustee or to make mandatory sinking fund payments or analogous payments as provided by Sections 401 or 403.

(b) The Company shall pay and shall indemnify the Trustee against any tax, fee or other charge imposed on or assessed against U.S. Government Obligations deposited pursuant to Sections 401 or 403, or the interest and principal received in respect of such obligations, other than any such tax, fee or other charge payable by or on behalf of Holders.

(c) The Trustee shall deliver or pay to the Company from time to time upon Company Request any U.S. Government Obligations or money held by it as provided in Sections 401 or 403 that, in the opinion of a nationally recognized firm of independent certified public accountants expressed in a written certification thereof delivered to the Trustee, are then in excess of the amount thereof that then would have been required to be deposited for the purpose for which such U.S. Government Obligations or money was deposited or received. This provision shall not authorize the sale by the Trustee of any U.S. Government Obligations held under this Indenture.

(d) Any monies paid by the Company to the Trustee or any Paying Agent, or held by the Company in trust, for the payment of the principal of or any interest or Additional Amounts on any Securities and remaining unclaimed at the end of two years after such principal, interest or Additional Amounts become due and payable will be repaid to the Company, or released from the trust, upon its written request, and upon such repayment or release all liability of the Company, the Trustee and such Paying Agent with respect thereto will cease.

#### SECTION 403. Satisfaction, Discharge and Defeasance of Securities of any Series

The Company, at its option, (i) will be discharged from any and all obligations in respect of the Securities of a series (except, in each case, for the obligations to register the transfer or exchange of the Securities of that series, replace stolen, lost or mutilated Securities of that series, maintain paying agencies, and hold moneys for payment in trust), or (ii) can omit to comply with any term, provision or condition set forth in Sections 1004, 1005 and 1011 with respect to the Securities of any series, *provided* that the following conditions shall have been satisfied:

- (i) the Company has deposited or caused to be irrevocably deposited (except as provided in Sections 607, 402(c), and the last paragraph of Section 1003) with the Trustee (specifying that each deposit is pursuant to this Section 403) as trust funds in trust, specifically pledged as security for, and dedicated solely to, the benefit of the Holders of the Securities of such series, (i) money, (ii) U.S. Government Obligations which through the payment of interest and principal in respect thereof in accordance with their terms will provide money in an amount, or (iii) a combination thereof, in each case, sufficient to pay and discharge the principal (and premium, if any) and interest, if any, on the outstanding Securities of such series on the dates such payments are due in accordance with the terms of the Securities of such series (or, if the Company has designated a Redemption Date pursuant to the final sentence of this paragraph, to and including the Redemption Date so designated by the Company); and
- (ii) no Event of Default or event that with notice or lapse of time would become an Event of Default (including by reason of such deposit) with respect to the Securities of such series shall have occurred and be continuing on the date of such deposit.

To exercise any such option, the Company is required to deliver to the Trustee (x) an Opinion of Counsel to the effect that the Holders of the Securities of such series will not recognize income, gain or loss for federal income tax purposes as a result of such deposit, defeasance and discharge of certain obligations, which in the case of clause (i) above must be based on a change in law or a ruling by the U.S. Internal Revenue Service, and (y) an Officers' Certificate as to compliance with all conditions precedent provided for in the Indenture relating



to the satisfaction and discharge of the Securities of such series. If the Company shall wish to deposit or cause to be deposited money or U.S. Government Obligations to pay or discharge the principal of (and premium, if any) and interest, if any, on the outstanding Securities of such series to and including a Redemption Date on which all of the outstanding Securities of such series are to be redeemed, such Redemption Date shall be irrevocably designated by a Board Resolution delivered to the Trustee on or prior to the date of deposit of such money or U.S. Government Obligations, and such Board Resolution shall be accompanied by an irrevocable Company Request that the Trustee give notice of such redemption, in the name and at the expense of the Company, not less than 15 or more than 30 days prior to such Redemption Date in accordance with this Indenture.

## ARTICLE V

### REMEDIES

#### SECTION 501. Events of Default

“*Event of Default*,” wherever used herein with respect to Securities of any series, means any one of the following events:

- (i) default in the payment of any interest or any Additional Amounts upon any Security of that series when it becomes due and payable and continuance of such default for a period of 30 days;
- (ii) default in the payment of the principal of (or premium, if any, on) any Security of that series at Maturity;
- (iii) material default in the performance, or material breach, of any covenant or obligation of the Company in this Indenture (other than a covenant or default in whose performance or whose breach is elsewhere in this Section 501 specifically dealt with or which has expressly been included in this Indenture solely for the benefit of a series of Securities other than that series) and continuance of such material default or breach for a period of 60 days after there has been given, by registered or certified mail, to the Company by the Trustee or to the Company and the Trustee by the Holders of at least 25% in aggregate principal amount of the Outstanding Securities of that series a written notice specifying such default or breach and requiring it to be remedied and stating that such notice is a “*Notice of Default*” hereunder;
- (iv) if this event shall be made to constitute an Event of Default with respect to the Securities of a particular series, a default in the payment of the principal of any bond, debenture, note or other evidence of indebtedness, in each case for money borrowed by the Company, or in the payment of principal under any mortgage, indenture (including this Indenture) or instrument under which there may be issued or by which there may be secured or evidenced any indebtedness for money borrowed by the Company, which default for payment of principal is in an aggregate principal amount exceeding \$50,000,000 (or its equivalent in any other currency or currencies) when such indebtedness becomes due and payable (whether at maturity, upon redemption or acceleration or otherwise), if such default shall continue unremedied or unwaived for more than 30 Business Days and the time for payment of such amount has not been expressly extended; *provided*, however, that, subject to the provisions of Sections 601 and 602, the Trustee shall not be deemed to have knowledge of such default unless either (a) a Responsible Officer of the Trustee shall have actual knowledge of such default or (b) the Trustee shall have received written notice thereof from the Company, from any Holder, from the holder of any such indebtedness or from the trustee under any such mortgage, indenture or other instrument; and *provided*, further, that if such default under such indenture or instrument shall be remedied or cured by the Company or waived by the holders of such indebtedness, then the Event of Default hereunder by reasons thereof shall be deemed likewise to have been remedied, cured or waived without further action upon the part of the Trustee or any of the Holders;
- (v) the failure of the Company generally to pay its debts as they become due, or the admission in writing of its inability to pay its debts generally, or the making of a general assignment for the benefit of its creditors, or the institution of any proceeding by or against the Company (other than any such proceeding brought against the Company that is dismissed within 180 days from the commencement thereof) seeking to adjudicate it bankrupt or insolvent, or seeking liquidation, winding up, reorganization, arrangement, adjustment, protection, relief or composition (in each case, other than a solvent liquidation, winding up, reorganization, arrangement, adjustment, protection, relief or composition) of it or its debts under any law relating to bankruptcy, insolvency, reorganization, moratorium or relief of debtors, or seeking the entry of an order for relief or appointment of an administrator, receiver, trustee, intervenor or other similar official for it or for any substantial part of its property, or the taking of any action by the Company to authorize any of the actions set forth in this clause (vi); or
- (vi) any other Event of Default provided in the supplemental indenture or provided in or pursuant to the Board Resolution under which such series of Securities is issued or in the form of Security for such series.

#### SECTION 502. Acceleration of Maturity; Rescission and Annulment

If an Event of Default with respect to Securities of any series at the time Outstanding occurs and is continuing, then in every such case the Trustee or the Holders of not less than 25% in aggregate principal amount of the Outstanding Securities of that series may declare the principal amount (or, if any of the Securities of that series are Original Issue Discount Securities, such portion of the principal amount of such Securities as may be specified in the terms thereof) of all of the Securities of that series to be due and payable immediately, by a notice in writing to the Company (and to the Trustee if given by Holders), and upon any such declaration such principal amount (or specified amount) shall become immediately due and payable.

At any time after such declaration of acceleration with respect to Securities of any series has been made, but before a

judgment or decree for payment of money has been obtained by the Trustee as hereinafter in this Article provided, if all Events of Default with respect to Securities of that series have been cured or waived (other than the non-payment of principal of the Securities that has become due solely by reason of such declaration of acceleration) then such declaration of acceleration, and its consequences shall be automatically annulled and rescinded.

No such rescission shall affect any subsequent default or impair any right consequent thereon.

For all purposes under this Indenture, if a portion of the principal of any Original Issue Discount Securities shall have been accelerated and declared due and payable pursuant to the provisions hereof, then, from and after such declaration, unless such declaration has been rescinded and annulled, the principal amount of such Original Issue Discount Securities shall be deemed, for all purposes hereunder, to be such portion of the principal thereof as shall be due and payable as a result of such acceleration, and payment of such portion of the principal thereof as shall be due and payable as a result of such acceleration, together with interest, if any, thereon and all other amounts owing thereunder, shall constitute payment in full of such Original Issue Discount Securities.

SECTION 503. Collection of Indebtedness and Suits for Enforcement by Trustee

The Company covenants that if:

- (i) default is made in the payment of any interest on any Security of a series when such interest becomes due and payable and such default continues for a period of 30 days, or
- (ii) default is made in the payment of the principal of (or premium, if any, on) any Security of a series at the Stated Maturity thereof,

the Company will, upon written demand of the Trustee, pay to it, for the benefit of the Holders of such Securities of such series, the whole amount then due and payable on such Securities of such series for principal (and premium, if any) and interest, if any, and, to the extent that payment of such interest shall be legally enforceable, interest on any overdue principal (and premium, if any) and any overdue interest, at the rate or rates prescribed therefor in such Securities of such series, and, in addition thereto, such further amount as shall be sufficient to cover the costs and expenses of collection, including the reasonable compensation, expenses, disbursements and advances of the Trustee, its agents, and its counsel.

If the Company fails to pay such amounts forthwith upon such demand, the Trustee, in its own name and as trustee of an express trust, (i) may institute a judicial proceeding for the collection of the sums so due and unpaid, (ii) may prosecute such proceeding to judgment or final decree, and (iii) may enforce the same against the Company or any other obligor upon such Securities and collect the moneys adjudged or decreed to be payable in the manner provided by law out of the property of the Company or any other obligor upon such Securities, wherever situated.

If any Event of Default with respect to Securities of any series occurs and is continuing, the Trustee may in its discretion proceed to protect and enforce its rights and the rights of the Holders of Securities of such series by such appropriate judicial proceedings as the Trustee shall deem most effectual to protect and enforce any such rights, subject, however, to Section 512.

SECTION 504. Trustee May File Proofs of Claim

In case of the pendency of any receivership, insolvency, liquidation (other than a solvent liquidation), bankruptcy, reorganization, arrangement, adjustment, composition or other judicial proceeding relative to the Company or any other obligor upon the Securities or the property of the Company or of such other obligor or their creditors, the Trustee (irrespective of whether the principal of the Securities shall then be due and payable as therein expressed or by declaration or otherwise and, irrespective of whether the Trustee shall have made any demand on the Company for the payment of overdue principal or interest), shall be entitled and empowered, by intervention in such proceeding or otherwise,

- (i) to file and provide a claim for the whole amount of principal (and premium, if any) and interest owing and unpaid in respect of the Securities and to file such other papers or documents as may be necessary or advisable in order to have the claims of the Trustee (including any claim for the reasonable compensation, expenses, disbursements, and advances of the Trustee, its agents, and its counsel) and of the Holders allowed in such judicial proceeding, and
- (ii) to collect and receive any moneys or other property payable or deliverable on any such claims and to distribute the same;

and any custodian, receiver, assignee, trustee, liquidator, sequestrator or other similar official in any such judicial proceeding is hereby authorized by each Holder to make such payments to the Trustee and, in the event that the Trustee shall consent to the making of such payments directly to the Holders, to pay to the Trustee any amount due it for the reasonable compensation, expenses, disbursements and advances of the Trustee, its agents and counsel, and any other amounts due the Trustee under Section 607.

Nothing herein contained shall be deemed to authorize the Trustee to authorize or consent to or accept or adopt on behalf of any Holder any plan or reorganization, arrangement, adjustment or composition affecting the Securities or the rights of any Holder thereof, or to authorize the Trustee to vote in respect of the claim of any Holder in any such proceeding.

SECTION 505. Trustee May Enforce Claims Without Possession of Securities

All rights of action and claims under this Indenture or the Securities may be prosecuted and enforced by the Trustee without the possession of any of the Securities or the production thereof in any proceeding relating thereto, and any such proceeding instituted by the Trustee shall be brought in its own name as trustee of an express trust, and any recovery of judgment shall, after provision for the payment of the reasonable compensation, expenses, disbursements, and advances of the Trustee, its agents, and its counsel, be for the ratable benefit of the Holders of the Securities in respect of which such judgment has been recovered.

SECTION 506. Application of Money Collected

Any money collected by the Trustee pursuant to this Article shall be applied in the following order with respect to the Securities of any series, at the date or dates fixed by the Trustee and, in case of the distribution of such money on account of principal (or premium, if any) or interest, upon presentation of the Securities and the notation thereon of the payment if only partially paid and upon surrender thereof if fully paid:

FIRST: To the payment of all amounts due the Trustee under Section 607;

SECOND: In case the principal and premium, if any, of the Securities of such series in respect of which moneys have been collected shall not have become and be then due and payable, to the payment of interest, if any, on the Securities of such a series in default in the order of the maturity of the installments of such interest, with interest (to the extent that such interest has been collected by the Trustee and to the extent permitted by law) upon the overdue installments of interest at the rate prescribed therefor in such Securities, such payments to be made ratably to the Persons entitled thereto, without discrimination or preference;

THIRD: In case the principal or premium, if any, of the Securities of such series in respect of which moneys have been collected shall have become and shall be then due and payable, to the payment of the whole amount then owing and unpaid upon all the Securities of such series for principal and premium, if any, and interest, if any, with interest upon the overdue principal and premium, if any, and (to the extent that such interest has been collected by the Trustee and to the extent permitted by law) upon overdue installments of interest at the rate prescribed therefor in the Securities of such series; and in case such money shall be insufficient to pay in full the whole amount so due and unpaid upon the Securities of such series, then to the payment of such principal and any premium and interest, without preference or priority of principal over interest, or of interest over principal or premium, or of any installment of interest over any other installment of interest, or of any Security of such series over any other Security of such series, ratably to the aggregate of such principal and any premium and accrued and unpaid interest; and

FOURTH: To the payment of the remainder, if any, to the Company or any other Person lawfully entitled thereto.

SECTION 507. Limitation on Suits

No Holder of any Security of any series shall have any right to institute any proceeding, judicial or otherwise, with respect to this Indenture, or for the appointment of a receiver or trustee, or for any other remedy hereunder, unless:

- (i) such Holder has previously given written notice to the Trustee of a continuing Event of Default with respect to the Securities of that series;
- (ii) the Holders of not less than 25% in principal amount of the Outstanding Securities of that series shall have made written request to the Trustee to institute proceedings in respect of such Event of Default in its own name as Trustee hereunder;
- (iii) such Holder or Holders have offered to the Trustee indemnity satisfactory to the Trustee against the costs, expenses, and liabilities to be incurred in compliance with such request;
- (iv) the Trustee for 60 days after its receipt of such notice, request, and offer of indemnity has failed to institute any such proceeding; and
- (v) no direction inconsistent with such written request has been given to the Trustee during such 60-day period by the Holders of a majority in principal amount of the outstanding Securities of that series;

it being understood and intended that no one or more of such Holders shall have any right in any manner whatever by virtue of, or by availing of, any provision of this Indenture to affect, disturb or prejudice the rights of any other of such Holders, or to obtain or to seek to obtain priority or preference over any other of such Holders or to enforce any right under this Indenture, except in the manner herein provided and for the equal and ratable benefit of all such Holders.

SECTION 508. Unconditional Right of Holders to Receive Principal, Premium and Interest

The Holder of any Security shall have the right, which is absolute and unconditional, to receive payment of the principal of (and premium, if any) and (subject to Section 308) interest, if any, on such Security on the Stated Maturity or Maturities expressed in such Security (or, in the case of redemption, on the Redemption Date) and to institute suit for the enforcement of any such payment, and such rights shall not be impaired without the consent of such Holder.

SECTION 509. Restoration of Rights and Remedies

If the Trustee or any Holder has instituted any proceeding to enforce any right or remedy under this Indenture and such

proceeding has been discontinued or abandoned for any reason, or has been determined adversely to the Trustee or to such Holder, then and in every such case, subject to any determination in such proceeding, the Company, the Trustee, and the Holders shall be restored severally and respectively to their former positions hereunder, and thereafter all rights and remedies of the Company, the Trustee, and the Holders shall continue as though no such proceeding had been instituted.

SECTION 510. Rights and Remedies Cumulative

Except as otherwise provided with respect to the replacement or payment of mutilated, destroyed, lost or stolen Securities in the last paragraph of Section 307, no right or remedy herein conferred upon or reserved to the Trustee or to the Holders is intended to be exclusive of any other right or remedy, and every right and remedy shall, to the extent permitted by law, be cumulative and in addition to every other right and remedy given hereunder or now or hereafter existing at law or in equity or otherwise. The assertion or employment of any right or remedy hereunder, or otherwise, shall not prevent the concurrent assertion or employment of any other appropriate right or remedy.

SECTION 511. Delay or Omission Not Waiver

No delay or omission of the Trustee or of any Holder of any Securities to exercise any right or remedy accruing upon any Event of Default shall impair any such right or remedy, or constitute a waiver of any such Event of Default or an acquiescence therein. Every right and remedy given by this Article or by law to the Trustee or to the Holders may be exercised from time to time, and as often as may be deemed expedient by the Trustee or by the Holders, as the case may be.

SECTION 512. Control by Holders

The Holders of a majority in principal amount of the Outstanding Securities of any series shall have the right to direct the time, method, and place of conducting any proceeding for any remedy available to the Trustee, or exercising any trust or power conferred on the Trustee, with respect to the Securities of such series, *provided* that:

- (i) such direction shall not be in conflict with any rule of law or with this Indenture;
- (ii) subject to provisions of Section 315 of the Trust Indenture Act, the Trustee may take any other action deemed proper by the Trustee that is not inconsistent with such direction;
- (iii) the Trustee shall not determine that the action so directed would be prejudicial to Holders not taking part in such action; and
- (iv) the Trustee has been furnished by such Holders an indemnity or security satisfactory to it against costs, expenses and liabilities which it might incur in connection therewith.

SECTION 513. Waiver of Past Defaults

Subject to Sections 508 and 902, the Holders of not less than a majority in aggregate principal amount of the Outstanding Securities of any series may, on behalf of the Holders of all the Securities of such series, waive any past default hereunder with respect to such series and its consequences, except a default

- (i) in the payment of the principal of (or premium, if any) or interest, if any, on any Security of such series, or
- (ii) in respect of a covenant or provision hereof which under Article IX cannot be modified or amended without the consent of the Holder of each Outstanding Security of such series affected.

Upon any such waiver, such default shall cease to exist, and any Event of Default arising therefrom shall be deemed to have been cured, for every purpose of this Indenture; *provided, however*, that no such waiver shall extend to any subsequent or other default or impair any right consequent thereon.

SECTION 514. Undertaking for Costs

All parties to this Indenture agree, and each Holder of any Security by his acceptance thereof shall be deemed to have agreed, that any court may in its discretion require, in any suit for the enforcement of any right or remedy under this Indenture, or in any suit against the Trustee for any action taken or omitted by it as Trustee, the filing by any party litigant in such suit of an undertaking to pay the costs of such suit, and that such court may in its discretion assess reasonable costs, including reasonable attorneys' fees, against any party litigant in such suit, having due regard to the merits and good faith of the claims or defenses made by such party litigant in such suit; *provided, however*, that the provisions of this Section 514 shall not apply to any suit instituted by the Trustee, to any suit instituted by any Holder, or group of Holders, holding in the aggregate more than 10% in principal amount of the outstanding Securities of any series, or to any suit instituted by any Holder for the enforcement of the payment of the principal of or interest, if any, on any Security on or after the Stated Maturity or Maturities expressed in such Security.

ARTICLE VI

THE TRUSTEE

SECTION 601. Certain Duties and Responsibilities

(a) Except during the continuance of a default with respect to the Securities of any series;

- (i) the Trustee undertakes to perform such duties and only such duties as are specifically set forth in this Indenture, and no implied covenants or obligations shall be read into this Indenture against the Trustee; and
- (ii) in the absence of bad faith or willful misconduct on its part, the Trustee may conclusively rely, as to the truth of the statements and the correctness of the opinions expressed therein, upon certificates or opinions furnished to the Trustee and conforming to the requirements of this Indenture; *provided* that in the case of any such certificates or opinions that by any provision hereof are specifically required to be furnished to the Trustee, the Trustee shall examine the same to determine whether or not they conform to the requirements of this Indenture, but not to verify the contents thereof.

(b) In case a default has occurred and is continuing, the Trustee shall exercise such of the rights and powers vested in it by this Indenture, and use the same degree of care and skill in their exercise, as a prudent person would exercise or use under the circumstances in the conduct of his or her own affairs.

(c) No provision of this Indenture shall be construed to relieve the Trustee from liability for its own negligent action, its own negligent failure to act, or its own willful misconduct, except that:

- (i) the Trustee shall not be liable for any error of judgment made in good faith by a Responsible Officer, unless the Trustee was negligent in ascertaining the pertinent facts;
- (ii) no provision of this Indenture shall require the Trustee to spend or risk its own funds or otherwise incur any financial liability in the performance of any of its duties hereunder, or in the exercise of any of its rights or powers, if repayment of such funds or adequate indemnity against such risk or liability satisfactory to the Trustee has not been assured to it; and
- (iii) the Trustee shall not be liable with respect to any action taken or omitted to be taken by it in good faith in accordance with the direction of the Holders of not less than a majority in principal amount of the Outstanding Securities of any series, determined as provided in Section 512, relating to the time, method, and place of conducting any proceeding for any remedy available to the Trustee, or exercising any trust or power conferred upon the Trustee, under this Indenture with respect to the Securities of such series.

(d) Whether or not therein expressly so provided, every provision of this Indenture relating to the conduct or affecting the liability of or affording protection to the Trustee shall be subject to the provisions of this Section 601.

#### SECTION 602. Notice of Defaults

Within 90 days after the occurrence of any default hereunder of which a Responsible Officer of the Trustee has actual knowledge with respect to the Securities of any series, the Trustee shall transmit by mail to all Holders of Securities of such series notice of such default hereunder known to the Trustee, unless such default shall have been cured or waived; *provided, however*, that, except in the case of a default in the payment of the principal of (or premium, if any) or interest, if any, on any Security of such series or in the payment, if any, of any sinking fund installment with respect to Securities of such series, the Trustee shall be protected in withholding such notice if and so long as the board of directors, the executive committee or a trust committee of directors and/or a Responsible Officer of the Trustee in good faith determine that the withholding of such notice is in the interest of the Holders of Securities of such series; and *provided, further*, that in the case of any default of the character specified in Section 501(iv) with respect to Securities of such series, no such notice to Holders shall be given until at least 30 days after the occurrence thereof. For the purpose of this Section 602, the term “*default*” means any event that is, or after notice or lapse of time or both would become, an Event of Default with respect to Securities of such series.

#### SECTION 603. Certain Rights of Trustee

Subject to the provisions of Section 601:

- (i) the Trustee may rely and shall be protected in acting or refraining from acting upon any resolution, certificate, statement, instrument, opinion, report, notice, request, direction, consent, order, bond, debenture, note, other evidence of indebtedness or other paper or document believed by it to be genuine and to have been signed or presented by the proper party or parties;
- (ii) any request or direction of the Company mentioned herein shall be sufficiently evidenced by a Company Request or Company Order or as otherwise expressly provided herein, and any resolution of the Board of Directors may be sufficiently evidenced by a Board Resolution;
- (iii) whenever in the administration of this Indenture the Trustee shall deem it desirable that a matter be proved or established prior to taking, suffering or omitting any action hereunder, the Trustee (unless other evidence be herein specifically prescribed) may, in the absence of bad faith or willful misconduct on its part, rely upon an Officers' Certificate;
- (iv) the Trustee may consult with counsel, and the written advice of such counsel or any Opinion of Counsel shall be full and complete authorization and protection in respect of any action taken, suffered or omitted by it hereunder in good faith and in reliance thereon;

- (v) the Trustee shall be under no obligation to expend or risk its own funds or to exercise, at the request or direction of any of the Holders, any of the rights or powers vested in it by this Indenture pursuant to this Indenture, unless such Holders shall have offered to the Trustee security or indemnity satisfactory to the Trustee against the costs, expenses, and liabilities that might be incurred by it in compliance with such request or direction;
- (vi) the Trustee shall not be bound to make any investigation into the facts or matters stated in any resolution, certificate, statement, instrument, opinion, report, notice, request, direction, consent, order, bond, debenture, note, other evidence of indebtedness or other paper or document; *provided, however*, that the Trustee, in its discretion, may make such further inquiry or investigation into such facts or matters as it may see fit, and, if the Trustee shall determine to make such further inquiry or investigation, it shall be entitled upon reasonable prior request and during normal business hours to examine the books, records, and premises of the Company, personally or by agent or attorney; and
- (vii) the Trustee may execute any of the trusts or powers hereunder or perform any duties hereunder either directly or by or through agents or attorneys and shall not be liable for the actions or omissions of such agents appointed and supervised by it with due care.
- (viii) Neither the Trustee nor any of its officers, directors, employees or agents shall be liable for any action taken or omitted under this Agreement or in connection therewith except to the extent caused by the Trustee's negligence, bad faith or willful misconduct, as determined by a court of competent jurisdiction.

SECTION 604. Trustee Not Responsible for Recitals or Issuance of Securities

The recitals contained herein and in the Securities, except the Trustee's certificates of authentication, shall be taken as the statements of the Company, and neither the Trustee nor any Authenticating Agent assumes any responsibility for their correctness. The Trustee makes no representations as to the validity or sufficiency of this Indenture or of the Securities or any offering materials related thereto, except that the Trustee represents that it is duly authorized to execute and deliver this Indenture, authenticate the Securities, and perform its obligations hereunder. Neither the Trustee nor any Authenticating Agent shall be accountable for the use or application by the Company of Securities or the proceeds thereof.

SECTION 605. May Hold Securities

The Trustee, any Authenticating Agent, any Paying Agent, any Security Registrar or any other agent of the Company, in its individual or any other capacity, may become the owner or pledgee of Securities and, subject to Sections 608 and 613, may otherwise deal with the Company with the same rights it would have if it were not Trustee, Authenticating Agent, Paying Agent, Security Registrar or such other agent.

SECTION 606. Money Held in Trust

Money held by the Trustee in trust hereunder need not be segregated from other funds, except to the extent required by law. The Trustee shall be under no liability for interest on any money received by it hereunder except as otherwise agreed with the Company.

SECTION 607. Compensation and Reimbursement

- (a) The Company agrees:
  - (i) to pay to the Trustee from time to time such compensation as is agreed upon in writing;
  - (ii) except as otherwise expressly provided herein, to reimburse the Trustee upon its request for all reasonable expenses, disbursements, and advances incurred or made by the Trustee in accordance with any provision of this Indenture (including the reasonable compensation and the expenses and disbursements of its agents, and its counsel, which compensation, expenses, and disbursements shall be set forth in sufficient written detail to the satisfaction of the Company), except any such expense, disbursement or advance as may be attributable to its or their negligence or bad faith;
  - (iii) to indemnify the Trustee, its officers, directors, and employees for, and to hold it harmless against, any loss, liability or expense incurred without negligence, bad faith, or willful misconduct on its part, arising out of or in connection with the acceptance or administration of the trust or trusts hereunder, including the costs and expenses of defending itself against any claim or liability in connection with the exercise or performance of any of its powers or duties hereunder. Obligations under this Section 607(iii) will survive the satisfaction and discharge of this Indenture pursuant to Section 401 hereof or the earlier resignation or removal of the Trustee; and
- (b) To secure the Company's payment obligations in this Section 607, the Trustee shall have a lien prior to the Securities on all money and property held or collected by the Trustee, in its capacity as Trustee, except money or property held in trust to pay principal of, and interest on particular Securities.
- (c) The obligations of the Company under this Section to compensate and indemnify the Trustee and to pay or reimburse the Trustee for expenses, disbursements and advances shall constitute additional indebtedness hereunder and shall survive the satisfaction and discharge of this Indenture or the rejection or termination of this Indenture under bankruptcy law. Such additional indebtedness shall be a senior claim to that of the Securities upon all property and funds held or collected by the

Trustee as such, and the Securities are hereby subordinated to such senior claim. If the Trustee renders services and incurs expenses following an Event of Default under Section 501(vi) hereof, the parties hereto and the Holders by their acceptance of the Securities hereby agree that such expenses are intended to constitute expenses of administration under any bankruptcy law.

SECTION 608. Disqualification; Conflicting Interests

If the Trustee has or shall acquire a conflicting interest within the meaning of the Trust Indenture Act, the Trustee shall either eliminate such interest or resign, to the extent and in the manner provided by, and subject to the provisions of, the Trust Indenture Act and this Indenture.

SECTION 609. Corporate Trustee Required; Eligibility

There shall at all times be a Trustee hereunder that shall be eligible to act as trustee under the Trust Indenture Act and that shall have a combined capital and surplus of at least \$50,000,000. If the Trustee does not have an office in The City of New York, the Trustee may appoint an agent in The City of New York reasonably acceptable to the Company to conduct any activities that the Trustee may be required under this Indenture to conduct in The City of New York. If the Trustee does not have an office in The City of New York or has not appointed an agent in The City of New York, the Trustee shall be a participant in DTC and FAST distribution systems. If such corporation publishes reports of condition at least annually, pursuant to law or to the requirements of a United States federal, state, territorial or District of Columbia supervising or examining authority, then for the purposes of this Section 609, the combined capital and surplus of such corporation shall be deemed to be its combined capital and surplus as set forth in its most recent report of condition so published. If at any time the Trustee shall cease to be eligible in accordance with the provisions of this Section 609, the Trustee shall resign immediately in the manner and with the effect hereinafter specified in this Article.

SECTION 610. Resignation and Removal; Appointment of Successor Trustee

(a) No resignation or removal of the Trustee and no appointment of a successor Trustee pursuant to this Article shall become effective until the acceptance of appointment by the successor Trustee in accordance with the applicable requirements of Section 611.

(b) The Trustee may resign at any time with respect to the Securities of one or more series by giving written notice thereof to the Company. If the instrument of acceptance by a successor Trustee required by Section 611 shall not have been delivered to the Trustee within 30 days after the giving of such notice of resignation, the resigning Trustee may petition any court of competent jurisdiction for the appointment of a successor Trustee with respect to the Securities of such series.

(c) The Trustee may be removed at any time with respect to the Securities of any series by an Act of the Holders of a majority in principal amount of the Outstanding Securities of such series, delivered to the Trustee and to the Company.

(d) If at any time:

- (i) the Trustee shall fail to comply with Section 310(b) of the Trust Indenture Act with respect to any series of Securities after written request by the Company or by any Holder who has been a bona fide Holder of a Security for at least six months,
- (ii) the Trustee shall cease to be eligible under Section 609 and shall fail to resign after written request by the Company or by any such Holder, or
- (iii) the Trustee shall become incapable of acting or shall be adjudged a bankrupt or insolvent or a receiver of the Trustee or of its property shall be appointed or any public officer shall take charge or control of the Trustee or of its property or affairs for the purpose of rehabilitation, conservation or liquidation,

then, in any such case, (A) the Company by a Board Resolution may remove the Trustee with respect to all Securities, or (B) subject to Section 514, any Holder who has been a bona fide Holder of a Security for at least six months may, on behalf of himself and all others similarly situated, petition any court of competent jurisdiction for the removal of the Trustee with respect to all Securities and the appointment of a successor Trustee or Trustees.

(e) If the Trustee shall resign, be removed or become incapable of acting, or if a vacancy shall occur in the office of Trustee for any cause, with respect to the Securities of one or more series, the Company, by a Board Resolution, shall promptly appoint a successor Trustee or Trustees with respect to the Securities of that or those series (it being understood that any such successor Trustee may be appointed with respect to the Securities of one or more or all of such series and that at any time there shall be only one Trustee with respect to the Securities of any particular series) and shall comply with the applicable requirements of Section 611. If no successor Trustee with respect to the Securities of any series shall have been so appointed by the Company and accepted appointment in the manner required by Section 611, any Holder who has been a bona fide Holder of a Security of such series for at least six months may, on behalf of himself and all others similarly situated, petition any court of competent jurisdiction for the appointment of a successor Trustee with respect to the Securities of such series.

(f) The Company shall give notice of each resignation and each removal of the Trustee with respect to the Securities of any series and each appointment of a successor Trustee with respect to the Securities of any series by mailing written notice of such event by first-class mail, postage prepaid, to all Holders of Securities of such series as their names and addresses appear in the Security Register. Each notice shall include the name of the successor Trustee with respect to the Securities of such series and the address of its Corporate Trust Office.

SECTION 611. Acceptance of Appointment by Successor

(a) In case of the appointment hereunder of a successor Trustee with respect to all Securities, every such successor Trustee so appointed shall execute, acknowledge, and deliver to the Company and to the retiring Trustee an instrument accepting such appointment, and thereupon the resignation or removal of the retiring Trustee shall become effective and such successor Trustee, without any further act, deed or conveyance, shall become vested with all the rights, powers, trusts, and duties of the retiring Trustee; *provided* that, on the request of the Company or the successor Trustee, such retiring Trustee shall, upon payment of its charges, execute and deliver an instrument transferring to such successor Trustee all the rights, powers, and trusts of the retiring Trustee and shall duly assign, transfer, and deliver to such successor Trustee all property and money held by such retiring Trustee hereunder.

(b) In case of the appointment hereunder of a successor Trustee with respect to the Securities of one or more (but not all) series, the Company, the retiring Trustee, and each successor Trustee with respect to the Securities of one or more series shall execute and deliver an indenture supplemental hereto wherein each successor Trustee shall accept such appointment and that (i) shall contain such provisions as shall be necessary or desirable to transfer and confirm to, and to vest in, each successor Trustee all the rights, powers, trusts, and duties of the retiring Trustee with respect to the Securities of that or those series to which the appointment of such successor Trustee relates, (ii) if the retiring Trustee is not retiring with respect to all Securities, shall contain such provisions as shall be deemed necessary or desirable to confirm that all the rights, powers, trusts, and duties of the retiring Trustee with respect to the Securities of that or those series as to which the retiring Trustee is not retiring shall continue to be vested in the retiring Trustee, and (iii) shall add to or change any of the provisions of this Indenture as shall be necessary to provide for or facilitate the administration of the trusts hereunder by more than one Trustee, it being understood that nothing herein or in such supplemental indenture shall constitute such Trustees co trustees of the same trust and that each such Trustee shall be trustee of a trust or trusts hereunder separate and apart from any trust or trusts hereunder administered by any other such Trustee; and, upon the execution and delivery of such supplemental indenture, the resignation or removal of the retiring Trustee shall become effective to the extent provided therein and each such successor Trustee, without any further act, deed or conveyance, shall become vested with all the rights, powers, trusts, and duties of the retiring Trustee with respect to the Securities of that or those series to which the appointment of such successor Trustee relates; *provided* that on request of the company or any successor trustee, such retiring Trustee shall duly assign, transfer and deliver to such successor Trustee all property and money held by such retiring Trustee hereunder with respect to the Securities of that or those series to which the appointment of such successor Trustee relates.

(c) Upon request of any such successor Trustee, the Company shall execute any and all instruments for more fully and certainly vesting in and conforming to such successor Trustee all such rights, powers, and trusts referred to in paragraph (a) or (b) of this Section 611, as the case may be.

(d) No successor Trustee shall accept its appointment unless, at the time of such acceptance, such successor Trustee shall be qualified and eligible under this Article.

SECTION 612. Merger, Conversion, Consolidation or Succession to Business

Any corporation into which the Trustee may be merged or converted or with which it may be consolidated, or any corporation resulting from any merger, conversion or consolidation to which the Trustee shall be a party, or any corporation succeeding to all or substantially all the corporate trust business of the Trustee, shall be the successor of the Trustee hereunder, *provided* such corporation shall be otherwise qualified and eligible under this Article, without the execution or filing of any paper or any further act on the part of any of the parties hereto. In case any Securities shall have been authenticated, but not delivered, by the Trustee then in office, any successor by merger, conversion or consolidation to such authenticating Trustee may adopt such authentication and deliver the Securities so authenticated with the same effect as if such successor Trustee had itself authenticated such Securities.

SECTION 613. Preferential Collecting of Claims Against Company

(a) Subject to Subsection (b) of this Section 613, if the Trustee shall be or shall become a creditor, directly or indirectly, secured or unsecured, of the Company within three months prior to a default, as defined in Subsection (c) of this Section 613, or subsequent to such a default, then, unless and until such default shall be cured, the Trustee shall set apart and hold in a special account for the benefit of the Trustee individually, the Holders of the Securities, and the holders of other indenture securities, as defined in Subsection (c) of this Section 613:

- (i) an amount equal to any and all reductions in the amount due and owing upon any claim as such creditor in respect of principal or interest effected after the beginning of such three months' period and valid as against the Company and its other creditors, except any such reduction resulting from the receipt or disposition of any property described in paragraph (ii) of this Subsection, or from the exercise of any right of set-off which the Trustee could have exercised if a petition in bankruptcy had been applied by or against the Company upon the date of such default; and
- (ii) all property received by the Trustee in respect of any claims as such creditor, either as security therefor, or in satisfaction or composition thereof, or otherwise, after the beginning of such three months' period, or an amount equal to the proceeds of any such property, if disposed of, *subject , however ,* to the rights, if any, of the Company and its other creditors in such property or such proceeds.

Nothing herein contained, however, shall affect the right of the Trustee:

- (i) to retain for its own account (A) payments made on account of any such claim by any Person (other than the Company) who



is liable thereon, (B) the proceeds of the bona fide sale of any such claim by the Trustee to a third Person, and (C) distributions made in cash, securities or other property in respect of claims filed against the Company in bankruptcy or receivership or in proceedings for reorganization pursuant to the Federal Bankruptcy Act or applicable State law;

- (ii) to realize, for its own account, upon any property held by it as security for any such claim, if such property was so held prior to the beginning of such three months' period;
- (iii) to realize, for its own account, but only to the extent of the claim hereinafter mentioned, upon any property held by it as security for any such claim, if such claim was created after the beginning of such three months' period and such property was received as security therefor simultaneously with the creation thereof, and if the Trustee shall sustain the burden of proving that at the time such property was so received the Trustee had no reasonable cause to believe that a default, as defined in Subsection (c) of this Section 613, would occur within three months; or
- (iv) to receive payment on any claim referred to in paragraph (ii) or (iii), against the release of any property held as security for such claim as provided in paragraph (ii) or (iii), as the case may be, to the extent of the fair value of such property.

For the purposes of paragraphs (ii), (iii) and (iv), property substituted after the beginning of such three months' period for property held as security at the time of such substitution shall, to the extent of the fair value of the property released, have the same status as the property released, and, to the extent that any claim referred to in any of such paragraphs is created in renewal of or in substitution for or for the purpose of repaying or refunding any pre-existing claim of the Trustee as such creditor, such claim shall have the same status as such pre-existing claim.

If the Trustee shall be required to account for the funds and property held in such special account, the proceeds thereof shall be apportioned among the Trustee, the Holders, and the holders of other indenture securities in such manner that the Trustee, the Holders, and the holders of other indenture securities realize, as a result of payments from such special account and payments of dividends on claims filed against the Company in bankruptcy or receivership or in proceedings for reorganization pursuant to the Federal Bankruptcy Act or applicable State law or winding up or administration pursuant to the insolvency laws of the United Kingdom, as applicable, the same percentage of their respective claims, figured before crediting to the claim of the Trustee anything on account of the receipt by it from the Company of the funds and property in such special account and before crediting to the respective claims of the Trustee and the Holders and the holders of other indenture securities dividends on claims filed against the Company in bankruptcy or receivership or in proceedings for reorganization pursuant to the Federal Bankruptcy Act or applicable State law or winding up or administration pursuant to the insolvency laws of the United Kingdom, as applicable, but after crediting thereon receipts on account of the indebtedness represented by their respective claims from all sources other than from such dividends and from the funds and property so held in such special account. As used in this paragraph, with respect to any claim, the term " *dividends* " shall include any distribution with respect to such claim, in bankruptcy or receivership or proceedings for reorganization pursuant to the Federal Bankruptcy Act or applicable State law or winding up or administration pursuant to the insolvency laws of the United Kingdom, as applicable, whether such distribution is made in cash, securities or other property, but shall not include any such distribution with respect to the secured portion, if any, of such claim.

Any Trustee that has resigned or been removed after the beginning of such three months' period shall be subject to the provisions of this Subsection as though such resignation or removal had not occurred. If any Trustee has resigned or been removed prior to the beginning of such three months' period, it shall be subject to the provisions of this Subsection if and only if the following conditions exist:

- (i) the receipt of property or reduction of claim, which would have given rise to the obligation to account, if such Trustee had continued as Trustee, occurred after the beginning of such three months' period; and
  - (ii) such receipt of property or reduction of claim occurred within three months after such resignation or removal.
- (b) There shall be excluded from the operation of Subsection (a) of this Section 613 a creditor relationship arising from:
- (i) the ownership or acquisition of securities issued under any indenture, or any security or securities having a maturity of one year or more at the time of acquisition by the Trustee;
  - (ii) advances authorized by a receivership or bankruptcy court of competent jurisdiction or by this Indenture, for the purpose of preserving any property that shall at any time be subject to the lien of this Indenture or of discharging tax liens or other prior liens or encumbrances thereon, if notice of such advances and of the circumstances surrounding the making thereof is given to the Holders at the time and in the manner provided in this Indenture;
  - (iii) disbursements made in the ordinary course of business in the capacity of trustee under an indenture, transfer agent, registrar, custodian, paying agent, fiscal agent or depository, or other similar capacity;
  - (iv) an indebtedness created as a result of services rendered or premises rented; or an indebtedness created as a result of goods or securities sold in a cash transaction, as defined in Subsection (c) of this Section 613;
  - (v) the ownership of stock or of other securities of a corporation organized under the provisions of Section 25(a) of the Federal Reserve Act, as amended, that is directly or indirectly a creditor of the Company; and
  - (vi) the acquisition, ownership, acceptance or negotiation of any drafts, bills of exchange, acceptances or obligations that fall within the classification of self-liquidating paper, as defined in Subsection (c) of this Section 613.

(c) For the purposes of this Section 613 only:

- (i) the term “ *default* ” means any failure to make payment in full of the principal of or interest on any of the Securities or upon the other indenture securities when and as such principal or interest becomes due and payable;
- (ii) the term “ *other indenture securities* ” means securities upon which the Company is an obligor (as defined in the Trust Indenture Act) outstanding under any other indenture (A) under which the Trustee is also trustee, (B) that contains provisions substantially similar to the provisions of this Section 613, and (C) under which a default exists at the time of the apportionment of the funds and property held in such special account;
- (iii) the term “ *cash transaction* ” means any transaction in which full payment for goods or securities sold is made within seven days after delivery of the goods or securities in currency or in checks or other orders drawn upon banks or bankers and payable upon demand;
- (iv) the term “ *self-liquidating paper* ” means any draft, bill of exchange, acceptance or obligation that is made, drawn, negotiated or incurred by the Company for the purpose of financing the purchase, processing, manufacturing, shipment, storage or sale of goods, wares or merchandise and that is secured by documents evidencing title to, possession of, or a lien upon, the goods, wares or merchandise or the receivables or proceeds arising from the sale of the goods, wares or merchandise previously constituting the security, provided the security is received by the Trustee simultaneously with the creation of the creditor relationship with the Company arising from the making, drawing, negotiating or incurring of the draft, bill of exchange, acceptance or obligation;
- (v) the term “ *Company* ” means any obligor upon the Securities; and
- (vi) the term “ *Federal Bankruptcy Act* ” means the Bankruptcy Code or Title 11 of the United States Code.

SECTION 614. Authenticating Agents

From time to time the Trustee, with the prior written approval of the Company, may appoint one or more Authenticating Agents with respect to one or more series of Securities with power to act on the Trustee’s behalf and subject to its direction in the authentication and delivery of Securities of such series, or in connection with transfers and exchanges under Sections 304, 305, 306 and 1104, as fully to all intents and purposes as though the Authenticating Agent had been expressly authorized by those Sections of this Indenture to authenticate and deliver Securities of such series. For all purposes of this Indenture, the authentication and delivery of Securities by an authenticating Agent pursuant to this Section 614 shall be deemed to be authentication and delivery of such Securities “ *by the Trustee* .” Each such Authenticating Agent shall be acceptable to the Company and shall at all times be a corporation organized and doing business under the laws of the United States, any State thereof or the District of Columbia, authorized under such laws to exercise corporate trust powers, having a combined capital and surplus of at least \$50,000,000, and subject to supervision or examination by Federal, State or District of Columbia authority. If such corporation publishes reports of condition at least annually pursuant to law or the requirements of such authority, then for the purposes of this Section 614 the combined capital and surplus of such corporation shall be deemed to be its combined capital and surplus as set forth in its most recent report of condition so published. If at any time an Authenticating Agent shall cease to be eligible in accordance with the provisions of this Section 614, such Authenticating Agent shall resign immediately in the manner and with the effect specified in this Section 614.

Any corporation into which any Authenticating Agent may be merged or with which it may be consolidated, or any corporation resulting from any merger or consolidation or to which any Authenticating Agent shall be a party, or any corporation succeeding to the corporate trust business of any Authenticating Agent, shall be the successor of the Authenticating Agent hereunder, if such successor corporation is otherwise eligible under this Section 614, without the execution or filing of any paper or any further act on the part of the parties hereto or the Authenticating Agent or such successor corporation.

An Authenticating Agent may resign at any time by giving written notice of resignation to the Trustee and to the Company. The Trustee may at any time terminate the agency of any Authenticating Agent by giving written notice of termination to such Authenticating Agent and to the Company. Upon receiving such a notice of resignation or upon such a termination, or in the case at any time any Authenticating Agent shall cease to be eligible under this Section 614, the Trustee may appoint a successor Authenticating Agent with the prior written approval of the Company and shall mail notice of such appointment to all Holders of Securities of the series with respect to which such Authenticating Agent will serve, as the names and addresses of such Holders appear on the Security Register. Any successor Authenticating Agent, upon acceptance of its appointment hereunder, shall become vested with all the rights, powers, and duties of its predecessor hereunder, with like effect as if originally named as an Authenticating Agent. No successor Authenticating Agent shall be appointed unless eligible under the provisions of this Section 614.

The Trustee agrees to pay to each Authenticating Agent from time to time reasonable compensation for its services under this Section 614 as may be agreed in a separate writing among the Company, the Trustee, and such Authenticating Agent, and the Trustee shall be entitled to be reimbursed for such payments pursuant to Section 607.

If an appointment with respect to one or more series of Securities is made pursuant to this Section 614, the Securities of such series may have endorsed thereon, in addition to the Trustee’s certificate of authentication, an alternate certificate of authentication in the form set forth in Section 205.

SECTION 615. The Principal Paying Agent, the Paying and Transfer Agent and Transfer Agent

The Principal Paying Agent, the Paying and Transfer Agent and Transfer Agent shall be afforded the same rights, protections, immunities and indemnities as the Trustee is afforded hereto.

ARTICLE VII

HOLDERS' LISTS AND REPORTS BY TRUSTEE AND COMPANY

SECTION 701. Company to Furnish Trustee Names and Addresses of Holders

The Company will furnish or cause to be furnished to the Trustee with respect to the Registered Securities of each series:

- (i) semi-annually, not later than 15 days after each Regular Record Date, or, in the case of any series of Registered Securities on which semi-annual interest is not payable, not more than 15 days after such semi-annual dates as may be specified by the trustee, a list, in such form as the Trustee may reasonably require, of the names and addresses of the Holders as of such Regular Record Date or semi-annual date, as the case may be; and
- (ii) at such other times as the Trustee may request in writing, within 30 days after the receipt by the Company of any such request, a list of similar form and content as of a date not more than 15 days prior to the time such list is furnished;

*provided, however*, that if and so long as the Trustee is the Security Registrar for any series of Registered Securities, no such list shall be required to be furnished with respect to any such series.

SECTION 702. Preservation of Information; Communications to Holders

(a) The Trustee shall preserve, in as current a form as is reasonably practicable, the names and addresses of Holders contained in the most recent list furnished to the Trustee as provided in Section 701 and the names and addresses of Holders received by the Trustee in its capacity as Security Registrar. The Trustee may destroy any list furnished to it as provided in Section 701 upon receipt of a new list so furnished.

(b) If three or more Holders (herein referred to as "*applicants*") apply in writing to the Trustee and furnish to the Trustee reasonable proof that each such applicant has owned a Security for a period of at least six months preceding the date of such application, and such application states that the applicants desire to communicate with other Holders with respect to their rights under this Indenture or under the Securities and is accompanied by a copy of the form of proxy or other communication which such applicants propose to transmit, then the Trustee shall, within five Business Days after the receipt of such application, at its election, either:

- (i) afford such applicants access to the information preserved at the time by the Trustee in accordance with Section 702(a); or
- (ii) inform such applicants as to the approximate number of Holders whose names and addresses appear in the information preserved at the time by the Trustee in accordance with Section 702(a), and as to the approximate cost of mailing to such Holders the form of proxy or other communication, if any, specified in such application.

If the Trustee shall elect not to afford such applicants access to such information, the Trustee shall, upon the written request of such applicants, mail to each Holder whose name and address appear in the information preserved at the time by the Trustee in accordance with Section 702(a), a copy of the form of proxy or other communication that is specified in such request, with reasonable promptness after a tender to the Trustee of the material to be mailed and of payment, or provision for the payment, of the reasonable expenses of mailing, unless within five days after such tender the Trustee shall mail to such applicants a written statement to the effect that, in the opinion of the Trustee, such mailing would be contrary to the best interest of the Holders or would be in violation of applicable law. Such written statement shall specify the basis of such opinion.

(c) Every Holder of Securities, by receiving and holding the same, agrees with the Company and the Trustee that neither the Company nor the Trustee nor any agent of either of them shall be held accountable, by reason of the disclosure of any such information as to the names and addresses of the Holders in accordance with Section 702(b), regardless of the source from which such information was derived, and that the Trustee shall not be held accountable by reason of mailing any material pursuant to a request made under Section 702(b).

SECTION 703. Reports by Trustee

(a) Within 60 days after May 15 of each year, commencing May 15, 2002, the Trustee shall transmit by mail to Holders of Securities a brief report dated as of such May 15 of such year with respect to any of the following events which may have occurred within the previous 12 months (but if no such event has occurred within such period no report need be transmitted):

- (i) any change to its eligibility under Section 609 and its qualifications under Section 608;
- (ii) the creation of or any material change to a relationship specified in Section 608;
- (iii) the character and amount of any advances (and if the Trustee elects so to state, the circumstances surrounding the making thereof) made by the Trustee (as such) that remain unpaid on the date of such report, and for the reimbursement of which it

claims or may claim a lien or charge, prior to that of the Securities, on any property or funds held or collected by it as Trustee, except that the Trustee shall not be required (but may elect) to report such advances if such advances so remaining unpaid aggregate not more than one-half of one percent of the principal amount of the Securities outstanding on the date of such report;

- (iv) any change to the amount, interest rate and maturity date of all other indebtedness owing by the Company (or by any other obligor on the Securities) to the Trustee in its individual capacity, on the date of such report, with a brief description of any property held as collateral security therefor, except an indebtedness based upon a creditor relationship arising in any manner described in Sections 613(b)(ii), (iii), (iv) or (vi);
- (v) any change to the property and funds, if any, physically in the possession of the Trustee as such on the date of such report;
- (vi) any additional issue of Securities that the Trustee has not previously reported; and
- (vii) any action taken by the Trustee in the performance of its duties hereunder that it has not previously reported and that in its opinion materially affects the Securities, except action in respect of a default, notice of which has been or is to be withheld by the Trustee in accordance with Section 602.

(b) The Trustee shall transmit by mail to all Holders of Securities a brief report with respect to the character and amount of any advances (and if the Trustee elects so to state, the circumstances surrounding the making thereof) made by the Trustee (as such) since the date of the last report transmitted pursuant to Subsection (a) of this Section 703 (or if no such report has yet been so transmitted, since the date of execution of this instrument) for the reimbursement of which it claims or may claim a lien or charge, prior to that of the Securities, on property or funds held or collected by it as Trustee and which it has not previously reported pursuant to this Subsection, except that the Trustee shall not be required (but may elect) to report such advances if such advances remaining unpaid at any time aggregate 10% or less of the principal amount of the Securities outstanding at such time, such report to be transmitted within 90 days after such time.

(c) A copy of each such report shall, at the time of such transmission to Holders, be filed by the Trustee with each U.S. stock exchange upon which any Securities are listed, if any, and with the Company. The Company will notify the Trustee when any Securities are listed on any U.S. stock exchange.

## ARTICLE VIII

### CONSOLIDATION, MERGER, CONVEYANCE, SALE OR LEASE

#### SECTION 801. Company May Consolidate Etc., Only on Certain Terms

Nothing contained in this Indenture shall prevent the Company from consolidating with or merging into another corporation or conveying, transferring or leasing its properties and assets substantially as an entirety to any Person; *provided* that (i) the successor entity assumes the Company's applicable obligations on the Securities and (ii) immediately after giving effect to such transaction, no Event of Default and no event that, after notice or lapse of time or both, would become an Event of Default, shall have happened and be continuing. In addition, the Company may assign and delegate all of its rights and obligations under this Indenture, the Securities, any supplemental indenture relating to the Securities, the Deposit Agreement and all other documents, agreements, and instruments related thereto to any Person that owns all of the ordinary shares of the Company or to any Person that owns all of the ordinary shares of a Person that owns all of the ordinary shares of the Company, and upon any such Person assuming such rights and obligations, the Company shall be automatically released from such obligations; *provided* that immediately after giving effect to such transaction no Event of Default and no event that, after notice or lapse of time or both, would become an Event of Default shall have happened and be continuing.

In the event that any such successor entity is organized under the laws of a country located outside of the United Kingdom and withholding or deduction is required by law for or on account of any present or future taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or within such country in which the successor entity is organized or by or within any political subdivision thereof or any authority therein thereof having power to tax, the successor entity shall pay to the relevant Holder of the Global Securities or to the relevant Holders of the definitive Registered Securities, as the case may be, such Additional Amounts, under the same circumstances and subject to the same limitations as are specified for "*United Kingdom Taxes*," as is set forth under Section 1009 herein, but substituting for the United Kingdom in each place the name of the country under the laws of which such successor entity is organized. In addition, such successor entity shall be entitled to effect optional tax redemptions under the same circumstances and subject to the same limitations as are set forth under Section 1108 herein, but substituting for the United Kingdom in each place the name of the country under the laws of which such successor entity is organized.

#### SECTION 802. Successor Corporation to be Substituted

Upon any consolidation by the Company with or merger by the Company into any other corporation or any conveyance, transfer or lease of the properties and assets of the Company substantially as an entirety in accordance with Section 801, the successor corporation formed by such consolidation or into which the Company is merged or to which such conveyance, transfer or lease is made shall proceed to, and be substituted for, and may exercise every right and power of, the Company under this Indenture with the same effect as if such successor corporation had been named as the Company herein, and thereafter the predecessor corporation shall be relieved of all obligations and covenants under this Indenture and the Securities.

## ARTICLE IX

## SUPPLEMENTAL INDENTURES

### SECTION 901. Supplemental Indentures without Consent of Holders

Without the consent of any Holders, the Company and the Trustee, at any time and from time to time, may enter into one or more indentures supplemental hereto, in form satisfactory to the Trustee, for any of the following purposes:

- (i) to evidence the succession of another corporation to the Company and the assumption by any such successor of the covenants of the Company herein and in the Securities;
- (ii) to add to the covenants of the Company for the benefit of the Holders of all or any series of Securities (and if such covenants are to be for the benefit of less than all series of Securities, stating that such covenants are expressly being included solely for the benefit of such series) or to surrender any right or power herein conferred upon the Company;
- (iii) to add any additional Events of Default (and if such Events of Default are to be for the benefit of less than all series of Securities, stating that such Events of Default are expressly being included solely for the benefit of such series);
- (iv) to add or to change any of the provisions of this Indenture to such extent as shall be necessary to permit or facilitate the issuance of securities in bearer form, registrable or not registrable as to principal, and with or without interest coupons, or to facilitate the issuance of Securities in uncertificated form, or to permit or facilitate the issuance of extendible Securities;
- (v) to change or eliminate any of the provisions of this Indenture, *provided* that any such change or elimination shall become effective only as to the Securities of any series created by such supplemental indenture and Securities of any series subsequently created to which such change or elimination is made applicable by the subsequent supplemental indenture creating such series;
- (vi) to secure the Securities;
- (vii) to establish the form or terms of Securities of any series as permitted by Sections 201 and 301;
- (viii) to evidence and provide for the acceptance of appointment hereunder by a successor Trustee with respect to the Securities of one or more series and to add to or change any of the provisions of this Indenture as shall be necessary to provide for or facilitate the administration of the trusts hereunder by more than one Trustee, pursuant to the requirements of Section 611(b);
- (ix) to provide for any rights of the Holders of Securities of any series to require the repurchase of Securities of such series by the Company;
- (x) to cure any ambiguity, to correct or supplement any provision herein that may be inconsistent with any other provision herein to evidence the merger of the Company or the replacement of the Trustee, or to make any other provisions with respect to matters or questions arising under this Indenture, *provided* that such action shall not materially and adversely affect the interests of the Holders of Securities of any series; or
- (xi) to modify, alter, amend or supplement this Indenture in any other respect that is not materially adverse to Holders, that does not involve a change described in clauses (i), (ii) or (iii) of Section 902 hereof, and that, in the reasonable judgment of the Trustee, is not to the prejudice of the Trustee, or in order to provide for the duties, responsibilities and compensation of the Trustee as a transfer agent in the event one registered Security of any series is issued in the aggregate principal amount of all outstanding Securities of such series in which Holders will hold an interest.

### SECTION 902. Supplemental Indentures with Consent of Holders

With the consent of the Holders of a majority in aggregate principal amount of the Outstanding Securities of all series affected by such supplemental indenture (voting as one class), by an Act of said Holders delivered to the Company and the Trustee, the Company, when authorized by or pursuant to a Board Resolution, and the Trustee may enter into an indenture or indentures supplemental hereto for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions of this indenture or of modifying in any manner the rights of the Holders of Securities of such series under this Indenture; *provided, however*, that no such supplemental indenture shall, without the consent of the Holder of each Outstanding Security affected thereby;

- (i) change the Stated Maturity of the principal of, or any installment of principal of or interest, if any, on, any Security, or reduce the principal amount thereof or the rate of interest thereon (including Additional Amounts) or any premium payable upon the redemption thereof, or reduce the amount of the principal of an Original Issue Discount Security that would be due and payable upon a declaration of acceleration of the Maturity thereof pursuant to Section 502, or change any Place of Payment where, or the coin or currency in which, any Security or any premium or the interest thereon is payable, or impair the right to institute suit for the enforcement of any such payment on or after the Stated Maturity thereof (or, in the case of redemption, on or after the Redemption Date);
- (ii) reduce the percentage in principal amount of the Outstanding Securities of any series, the consent of whose Holders is required for any such supplemental indenture, or the consent of whose Holders is required for any waiver of compliance with

certain provisions of this Indenture or certain defaults hereunder and their consequences provided for in this Indenture; or

- (iii) modify any of the provisions of this Section 902 or Section 513, except to increase any such percentage or to provide that certain other provisions of this Indenture cannot be modified or waived without the consent of the Holder of each Outstanding Security affected thereby; *provided, however*, that this clause shall not be deemed to require the consent of any Holder with respect to changes in the references to “ *the Trustee* ” and concomitant changes in this Section 902, or the deletion of this proviso, in accordance with the requirements of Sections 611(b) and 901(viii).

A supplemental indenture that changes or eliminates any covenant or other provision of this Indenture that has expressly been included solely for the benefit of one or more particular series of Securities, or that modifies the rights of the Holders of Securities of such series with respect to such covenant or other provision, shall be deemed not to affect their rights under this Indenture of the Holders of Securities of any other series.

It shall not be necessary for any Act of Holders under this Section 902 to approve the particular form of any proposed supplemental indenture, but it shall be sufficient if such Act shall approve the substance thereof.

#### SECTION 903. Execution of Supplemental Indentures

In executing, or accepting the additional trusts created by, any supplemental indenture permitted by this Article or modifications thereby of the trusts created by this Indenture, the Trustee shall be entitled to receive, and (subject to Section 601) shall be fully protected in relying upon, an Opinion of Counsel stating that the execution of such supplemental indenture is authorized or permitted by this Indenture. The Trustee may, but shall not be obligated to, enter into any such supplemental indenture which affects the Trustee’s own rights, duties or immunities under this Indenture or otherwise.

#### SECTION 904. Effect of Supplemental Indentures

Upon the execution of any supplemental indenture under this Article, this Indenture shall be modified in accordance therewith, and such supplemental indenture shall form a part of this Indenture for all purposes; and every Holder of Securities theretofore or thereafter authenticated and delivered hereunder shall be bound thereby.

#### SECTION 905. Conformity with Trust Indenture Act

Every supplemental indenture executed pursuant to this Article shall, if so required by the Trust Indenture Act, conform to the requirements of the Trust Indenture Act as then in effect.

#### SECTION 906. Reference in Securities to Supplemental Indentures

Securities of any series authenticated and delivered after the execution of any supplemental indenture pursuant to this Article may, and shall if required by the Trustee, bear a notation in form approved by the Trustee as to any matter provided for in such supplemental indenture. If the Company shall so determine, new Securities of any series so modified as to conform, in the opinion of the Trustee and the Company, to any such supplemental indenture may be prepared and executed by the Company and authenticated and delivered by the Trustee in exchange for Outstanding Securities of such series.

### ARTICLE X

#### COVENANTS

#### SECTION 1001. Payment of Principal, Premium, if any, and Interest

The Company covenants and agrees for the benefit of each series of Securities that it will duly and punctually pay the principal of (and premium, if any) and interest and Additional Amounts, if any, on the Securities of that series in accordance with the terms of the Securities and this Indenture. An installment of principal of or interest on the Securities of a series shall be considered paid on the date it is due if the Trustee or Paying Agent holds at 11:00 a.m., New York City time, on that date money deposited by the Company in immediately available funds and designated for, and sufficient to pay, the installment in full.

Neither the Company nor any agent of the Company will have any responsibility or liability for any aspect relating to payment made or to be made by the Book-Entry Depository to DTC in respect of the Securities of a series or the Book-Entry Interests. None of the Company, the Trustee, the Book-Entry Depository or any agent of any of the foregoing will have any responsibility or liability for any aspect relating to payments made or to be made by DTC on account of a Participant’s or Indirect Participant’s ownership of an interest in the Book-Entry Interest or for maintaining, supervising or reviewing any records relating to a Participant’s interests in the Book-Entry Interest.

#### SECTION 1002. Maintenance of Office or Agency

The Company will maintain (i) in the Borough of Manhattan, The City of New York, an office or agency where Securities of any series may be presented or surrendered for payment, and where notices and demands to or upon the Company in respect of the Securities of such series and this Indenture may be served and if definitive Registered Securities have been issued, an office or agency of a Transfer Agent where securities may be surrendered for registration of transfer or exchange, and (ii) an office or agency of a Paying Agent where the Securities may be paid in Luxembourg so long as the Securities are listed on the Luxembourg Stock Exchange and the rules of such exchange so

require. The Company will give prompt written notice to the Trustee of the location, and any change in the location, of any such office or agency. If at any time the Company shall fail to maintain any such required office or agency or shall fail to furnish the Trustee with the address thereof, such presentations, surrenders, notices, and demands may be made or served at the Corporate Trust Office of the Trustee, except that Bearer Securities of that series pursuant to Section 1001 may be presented at the place specified for the purpose pursuant to Section 301, and the Company hereby appoints the Paying Agent as its agent to receive all such presentations, surrenders, notices, and demands.

The Company may also from time to time designate one or more other offices or agencies (in or outside of such Place of Payment) where the Securities of one or more series and any appurtenant coupons (subject to Section 1001) may be presented or surrendered for any or all of such purposes, and may from time to time rescind such designations; *provided, however*, that no such designation or rescission shall in any manner relieve the Company of its obligation to maintain an office or agency in each Place of Payment for any series of Securities for such purposes. The Company will give prompt written notice to the Trustee of any such designation and any change in the location of any such other office or agency. The Company will at all time maintain at least one Paying Agent that is located outside the United Kingdom for each series of Securities.

#### SECTION 1003. Money for Securities Payments to Be Held in Trust

If the Company shall at any time act as its own Paying Agent with respect to any series of Securities, it will, on or before each due date of the principal of (and premium, if any) or interest, if any, on any of the Securities of that series, segregate and hold in trust for the benefit of the Persons entitled thereto a sum sufficient to pay the principal (and premium, if any) or interest, if any, so becoming due until such sums shall be paid to such Persons or otherwise disposed of as herein provided and will promptly notify the Trustee of its action or failure so to act.

Whenever the Company shall have one or more Paying Agents for any series of Securities, it will, no later than 10:00 a.m., New York Time, on or prior to each due date of the principal of (and premium, if any) or interest, if any, on any Securities of that series, deposit with a Paying Agent a sum in immediately available funds sufficient to pay the principal (and premium, if any) or interest so becoming due, such sum to be held in trust for the benefit of the Persons entitled to such principal, premium or interest.

The Company will cause each Paying Agent for any series of Securities other than the Trustee to execute and deliver to the Trustee an instrument in which such Paying Agent shall agree with the Trustee, subject to the provisions of this Section 1003, that such Paying Agent will:

- (i) hold all sums held by it for the payment of the principal of (and premium, if any) or interest, if any, on Securities of that series in trust for the benefit of the Persons entitled thereto until such sums shall be paid to such Persons or otherwise disposed of as herein provided;
- (ii) give the Trustee notice of any default by the Company (or any other obligor upon the Securities of that series) in the making of any payment of principal (and premium, if any) or interest, if any, on the Securities of that series; and
- (iii) at any time during the continuance of any such default, upon the written request of the Trustee, forthwith pay to the Trustee all sums so held in trust by such Paying Agent.

The Company may at any time, for the purpose of obtaining the satisfaction and discharge of this Indenture or for any other purpose, pay, or by Company Order direct any Paying Agent to pay, to the Trustee all sums held in trust by the Company or such Paying Agent, such sums to be held by the Trustee upon the same trusts as those upon which such sums were held by the Company or such Paying Agent; and, upon such payment by the Company or by any Paying Agent to the Trustee, the Company or such Paying Agent, as the case may be, shall be released from all further liability with respect to such money.

Any money deposited with the Trustee or any Paying Agent, or then held by the Company, in trust for the payment of the principal of (and premium, if any) or interest, if any, on any Security of any series and remaining unclaimed for two years after such principal (and premium, if any) or interest has become due and payable shall be paid to the Company on Company Request, or (if then held by the Company) shall be discharged from such trust; and the Holder of such Security shall thereafter, as an unsecured general creditor, look only to the Company for payment thereof, and all liability of the Trustee or such Paying Agent with respect to such trust money, and all liability of the Company as trustee thereof, shall thereupon cease.

#### SECTION 1004. Limitation on Liens

If this covenant shall be made applicable to the Securities of a particular series, the Company shall not issue, assume or guarantee any notes, bonds, debentures or other similar evidences of indebtedness of a kind typically traded on a stock exchange, in each case for money borrowed ("Debt"), secured by a Lien upon any property or assets (other than cash) without effectively providing that the outstanding Securities (together with, if the Company so determines, any other indebtedness or obligation then existing or thereafter created ranking equally with such Securities) shall be secured equally and ratably with (or prior to) such Debt so long as such Debt shall be so secured. The foregoing restriction on Liens will not, however, apply to:

- (i) Liens in existence on the date of original issue of such Securities;
- (ii) (A) any Lien created or arising over any property which is acquired, constructed or created by the Company, but only if (1) such Lien secures only principal amounts (not exceeding the cost of such acquisition, construction or creation) raised for the

purposes of such acquisition, construction or creation, together with any costs, expenses, interest and fees incurred in relation thereto or a guarantee given in respect thereof, (2) such Lien is created or arises on or before 90 days after the completion of such acquisition, construction or creation, and (3) such Lien is confined solely to the property so acquired, constructed or created; or (B) any Lien to secure indebtedness for borrowed money incurred in connection with a specifically identifiable project where the Lien relates to a property (including, without limitation, shares or other rights of ownership in the entity (ies) which own such property or project) involved in such project and acquired by the Company after the date of original issue of the Securities and the recourse of the creditors in respect of such indebtedness is limited to any or all of such project and property (including as aforesaid);

- (iii) any Lien securing amounts not more than 90 days overdue or otherwise being contested in good faith;
- (iv) (A) rights of financial institutions to offset credit balances in connection with the operation of cash management programs established for the benefit of the Company or in connection with the issuance of letters of credit for the benefit of the Company; (B) any Lien securing indebtedness of the Company for borrowed money incurred in connection with the financing of accounts receivable; (C) any Lien incurred or deposits made in the ordinary course of business, including, but not limited to, (1) any mechanics', materialmens', carriers', workmens', vendors' or other like Liens and (2) any Liens securing amounts in connection with workers' compensation, unemployment insurance, and other types of social security; (D) any Lien upon specific items of inventory or other goods and proceeds of the Company securing obligations of the Company in respect of bankers' acceptances issued or created for the account of such person to facilitate the purchase, shipment or storage of such inventory or other goods; (E) any Lien incurred or deposits made securing the performance of tenders, bids, leases, trade contracts (other than for borrowed money), statutory obligations, surety bonds, appeal bonds, government contracts, performance bonds, return-of-money bonds, and other obligations of like nature incurred in the ordinary course of business; (F) any Lien created by the Company under or in connection with or arising out of any pooling and settlement agreements or pooling and settlement arrangements of the electricity industry or any transactions or arrangements entered into in connection with hedging or management of risks relating to the electricity industry; (G) any Lien constituted by a right of set off or right over a margin call account or any form of cash or cash collateral or any similar arrangement for obligations incurred in respect of the hedging or management of risks under transactions involving any currency or interest rate swap, cap or collar arrangements, forward exchange transaction, option, warrant, forward rate agreement, futures contract or other derivative instrument of any kind; (H) any Lien arising out of title retention or like provisions in connection with the purchase of goods and equipment in the ordinary course of business; and (I) any Lien securing reimbursement obligations under letters of credit, guaranties and other forms of credit enhancement given in connection with the purchase of goods and equipment in the ordinary course of business;
- (v) Liens in favor of the Company or one of its subsidiaries;
- (vi) (A) Liens on any property or assets acquired from a corporation which is merged with or into the Company, or any Liens on the property or assets of any corporation or other entity existing at the time such corporation or other entity becomes a Subsidiary of the Company and, in either such case, is not created in anticipation of any such transaction (unless such Lien is created to secure or provide for the payment of any part of the purchase price of such corporation); (B) any Lien on any property or assets existing at the time of acquisition thereof and which is not created in anticipation of such acquisition (unless such Lien was created to secure or provide for the payment of any part of the purchase price of such property or assets); and (C) any Lien created or outstanding on or over any asset of any company which becomes a Subsidiary on or after the date of the issuance of such Securities where such Lien is created prior to the date on which such company becomes a Subsidiary;
- (vii) Liens required by any contract or statute in order to permit the Company to perform any contract or subcontract made by it with or at the request of a governmental entity or any department, agency or instrumentality thereof, or to secure partial, progress, advance or any other payments by the Company to such governmental unit pursuant to the provisions of any contract or statute; (B) any Lien securing industrial revenue, development or similar bonds issued by or for the benefit of the Company, *provided* that such industrial revenue, development or similar bonds are non-recourse to the Company; and (C) any Lien securing taxes or assessments or other applicable governmental charges or levies;
- (viii) (A) any Lien which arises pursuant to any order of attachment, distraint or similar legal process arising in connection with court proceedings and any Lien which secures the reimbursement obligation for any bond obtained in connection with an appeal taken in any court proceeding, so long as the execution or other enforcement of such Lien arising pursuant to such legal process is effectively stayed and the claims secured thereby are being contested in good faith and, if appropriate, by appropriate legal proceedings, or any Lien in favor of a plaintiff or defendant in any action before a court or tribunal as security for costs and/or other expenses; or (B) any Lien arising by operation of law or by order of a court or tribunal or any Lien arising by an agreement of similar effect, including, without limitation, judgment Liens; or
- (ix) any extension, renewal or replacement (or successive extensions, renewals or replacements), as a whole or in part, of any Liens referred to in the foregoing clauses, for amounts not exceeding the principal amount of the Debt secured by the Lien so extended, renewed or replaced, *provided* that such extension, renewal or replacement Lien is limited to all or a part of the same property or assets that were covered by the Lien extended, renewed or replaced (plus improvements on such property or assets).

Notwithstanding the foregoing, the Company may create or permit to subsist Liens over any property or assets, so long as the aggregate amount of Debt secured by all such Liens (excluding therefrom the amount of Debt secured by Liens set forth in clauses (i) through



(ix), inclusive, above) does not exceed 10% of the Consolidated Net Tangible Assets.

Nothing contained in this Indenture in any way restricts or prevents the Company or any Subsidiary from incurring any indebtedness.

SECTION 1005. Limitation on Sale and Lease-Back Transactions

If this covenant shall be made applicable to the Securities of a particular series, the Company covenants and agrees that, so long as any Securities of such series remain outstanding, it will not enter into any arrangement with any Person providing for the leasing by the Company of any assets which have been or are to be sold or transferred by the Company to such Person (a “*Sale and Lease-Back Transaction*”) unless:

- (i) such transaction involves a lease for a temporary period not to exceed three years;
- (ii) such transaction is between the Company and a subsidiary or affiliate of the Company;
- (iii) the Company would be entitled to incur indebtedness secured by a Lien on the assets or property involved in such transaction at least equal in amount to the attributable debt with respect to such Sale and Lease-Back Transaction, without equally and ratably securing the Securities, pursuant to the limitation on Liens described above, other than pursuant to the penultimate paragraph thereof;
- (iv) such transaction is entered into within 60 days after the initial acquisition by the Company of the assets or property subject to such transaction;
- (v) after giving effect thereto, the aggregate amount of all attributable debt with respect to all such Sale and Lease-Back Transactions does not exceed 10% of the Consolidated Net Tangible Assets; or
- (vi) the Company, within the 12 months preceding the sale or transfer or the 12 months following the sale or transfer, regardless of whether such sale or transfer may have been made by the Company, applies, in the case of a sale or transfer for cash, an amount equal to the net proceeds thereof, and, in the case of a sale or transfer otherwise than for cash, an amount equal to the fair value of the assets so leased at the time of entering into such arrangement (as determined by the Board of Directors of the Company), (A) to the retirement of indebtedness for money borrowed, incurred or assumed by the Company which by its terms matures at, or is extendible or renewable at the option of the obligor to, a date more than 12 months after the date of incurring, assuming or guaranteeing such debt, or (B) to investment in any assets of the Company.

SECTION 1006. Statement by Officers as to Default

The Company will deliver to the Trustee within 120 days after the end of each fiscal year of the Company a certificate from the principal executive, financial or accounting officer of the Company, stating that in the course of the performance by each signer of his or her duties as an officer of the Company he or she would normally have knowledge of any default by the Company in the performance and observance of any of the covenants contained in this Indenture, stating whether or not he or she has knowledge of any such default without regard to any period of grace of requirement of notice and, if so, specifying each such default of which such signer has knowledge and the nature thereof.

SECTION 1007. Modification or Waiver of Certain Covenants

The Company may omit in any particular instance to comply with any term, provision or condition set forth in this Indenture with respect to the Securities of a series if, before the time for such compliance, the Holders of a least a majority in aggregate principal amount of the Outstanding Securities of such series shall, by Act of such Holders, either modify the covenant or waive such compliance in such instance or generally waive compliance with such term, provision or condition; *provided* that no such modification shall, without the consent of each Holder of Securities of such series, (i) change the stated maturity upon which the principal of or the interest on the Securities of such series is due and payable, (ii) reduce the principal amount thereof or the rate of interest thereon, (iii) change any obligation of the Company to pay Additional Amounts with respect to such services, (iv) change any Place of Payment or the currency in which the Securities of such series or any premium or the interest thereon is payable, (v) impair the right to institute suit for the enforcement of any such payment on or after the Stated Maturity thereof (or, in the case of the redemption, on or after the Redemption Date), (vi) reduce the percentage in principal amount of the outstanding Securities of such series, the consent of whose holders is required for any waiver of compliance with certain provisions of the Indenture or certain defaults thereunder and their consequences provided for in the Indenture or (vii) reduce the requirements contained in the Indenture for quorum or voting with respect to such series. The Securities owned by the Company or any of its affiliates shall be deemed not to be outstanding for, among other purposes, consenting to any such modification.

SECTION 1008. Further Assurances

The Company and the Trustee will execute and deliver all such documents, instruments and agreements, and do all such other acts and things as may be reasonably required to enable the Trustee to exercise and enforce its rights under the Indenture and under the documents, instruments and agreements required under the Indenture, and to carry out the intent of the Indenture.

SECTION 1009. Payment of Additional Amounts

If the Securities of a particular series provide for payment of Additional Amounts, all payments of principal and interest (including payments of discount and premium, if any) in respect of the Securities of such series shall be made free and clear of, and without withholding or deduction for or on account, of any present or future taxes, duties, assessments or governmental charges of whatever nature imposed, levied, collected, withheld or assessed by or within the United Kingdom or by or within any political subdivision thereof or any authority therein or thereof having power to tax (“*United Kingdom Taxes*”), unless such withholding or deduction is required by law. In that event the Company shall pay to the Holder such additional amounts (the “*Additional Amounts*”) as will result in the payment to such Holder of the amount that would otherwise have been receivable by such Holder in the absence of such withholding or deduction, except that no such Additional Amounts shall be payable:

- (i) to, or to a Person on behalf of, a Holder who is liable for such United Kingdom Taxes in respect of Securities by reason of such Holder having some connection with the United Kingdom (including being a citizen or resident or national of, or carrying on a business or maintaining a permanent establishment in, or being physically present in, the United Kingdom) other than the mere holding of a Security or the receipt of principal and interest (including payments of discount and premium, if any) in respect thereof;
- (ii) to, or to a Person on behalf of, a Holder who presents a Security (where presentation is required) for payment more than 30 days after the Relevant Date, except to the extent that such Holder would have been entitled to such Additional Amounts on presenting such Security for payment on the last day of such period of 30 days;
- (iii) to, or to a Person on behalf of, a Holder who presents a Security (where presentation is required) in the United Kingdom; or
- (iv) to, or to a Person on behalf of, a Holder who would not be liable or subject to the withholding or deduction by making a declaration of non-residence or similar claim for exemption to the relevant tax authority.

Such Additional Amounts will also not be payable where, had the beneficial owner of the Security (or any interest therein) been the Holder of the Security, he or she would not have been entitled to payment of Additional Amounts by reason of any one or more of clauses (i) through (iv) above. If the Company shall determine that Additional Amounts will not be payable because of the immediately preceding sentence, the Company will inform such Holder promptly after making such determination setting forth the reason(s) therefor.

Reference to principal, interest, discount or premium in respect of the Securities shall be deemed also to refer to any Additional Amounts that may be payable as set forth in this Indenture or in the Securities.

At least 10 Business Days prior to the first Interest Payment Date (and at least 10 Business Days prior to each succeeding Interest Payment Date if there has been any change with respect to the matters set forth in the below-mentioned Officers’ Certificate), the Company will furnish to the Trustee and the Paying Agents an Officers’ Certificate instructing the Trustee and the Paying Agents whether payments of principal or interest on the Securities due on such Interest Payment Date shall be without deduction or withholding for or on account of any United Kingdom. If any such deduction or withholding shall be required, prior to such Interest Payment Date, the Company will furnish the Trustee and the Paying Agents with an Officers’ Certificate that specifies the amount, if any, required to be withheld on such payment to Holders and certifies that the Company shall pay such withholding or deduction. The Company covenants to indemnify the Trustee for, and to hold the Trustee harmless against, any loss, liability or expense reasonably incurred without negligence, willful misconduct or bad faith on their part, arising out of or in connection with actions taken or omitted by the Trustee in reliance on any Officers’ Certificate furnished pursuant to this paragraph. Any Officers’ Certificate required by this Section 1009 to be provided to the Trustee and any Paying Agent shall be deemed to be duly provided if telecopied to the Trustee and such Paying Agent.

The Company shall furnish to the Trustee the official receipts (or a certified copy of the official receipts) evidencing payment of United Kingdom Taxes. Copies of such receipts shall be made available to the Holders of the Securities upon request.

#### SECTION 1010. Copies Available to Holders

Copies of this Indenture shall be available for inspection by the Holders upon receipt of written request on a Business Day during normal business hours at the principal office of the Company and at the Corporate Trust Office. In addition, if the Securities of any series are listed on the London Stock Exchange, the Luxembourg Stock Exchange or any other stock exchange located outside the United States and such stock exchange shall so require, copies of this Indenture, the Deposit Agreement, the Letter of Representations, the memorandum and articles of association of the Company, and the most recent publicly available annual report of the Company shall be made available for inspection by the Holders of such Securities upon receipt of written request on a Business Day during normal business hours at the offices of the paying agents and at the office of the listing agent required to be maintained by such exchange for so long as the Securities of such series are Outstanding and are listed on such stock exchange.

#### SECTION 1011. Limitation on the Incurrence of Additional Indebtedness by Certain Subsidiaries

If this covenant shall be made applicable to the Securities of a particular series, the Company covenants and agrees that, so long as any Securities of such series remain outstanding, it shall prevent any Subsidiary, whether currently in existence or formed after the date hereof, that is a direct or indirect parent of Southern Investments UK plc, from incurring any indebtedness for borrowed money under any circumstances, excluding any indebtedness that exists as of the date hereof.

### ARTICLE XI

#### REDEMPTION OF SECURITIES

SECTION 1101. Applicability of Article

Securities of any series that are redeemable before their Stated Maturity shall be redeemable in accordance with their terms and (except as otherwise specified in or contemplated by Section 301 for Securities of any series) in accordance with this Article XI.

SECTION 1102. Election to Redeem: Notice to Trustee

The election of the Company to redeem any Securities shall be authorized by a Board of Directors resolution and evidenced by an Officers' Certificate. In case of any redemption at the election of the Company of less than all the Securities of any series, the Company shall, at least 15 days prior to the Redemption Date fixed by the Company (unless a shorter notice shall be satisfactory to the Trustee), notify the Trustee of such Redemption Date and of the principal amount of Securities of such series to be redeemed. In the case of any redemption of Securities prior to the expiration of any restriction on such redemption provided in the terms of such Securities or elsewhere in this Indenture, or pursuant to an election by the Company that is subject to a condition specified in the terms of such Securities or elsewhere in this Indenture, the Company shall furnish the Trustee with an Officers' Certificate evidencing compliance with such restriction or condition.

SECTION 1103. Selection by Trustee of Securities to Be Redeemed

If less than all the Securities of any series are to be redeemed, the particular securities to be redeemed shall be selected not more than 60 days prior to the Redemption Date by the Trustee, from the Outstanding Securities of such series not previously called for redemption, by such method as the Trustee shall deem fair and appropriate and that may provide for the selection for redemption of portions equal to the minimum authorized denomination for Securities of that series (or any integral multiple thereof) of the principal amount of Securities of such series of a denomination larger than the minimum authorized denomination for Securities of that series.

Securities shall be excluded from eligibility for selection for redemption if they are identified by certificate number in a written statement signed by an authorized officer of the Company and delivered to the Security Registrar at least 30 days prior to the Redemption Date as being owned of record and beneficially by, and not pledged or hypothecated by either (i) the Company or (ii) an entity specifically identified in such written statement which is an Affiliate of the Company.

The Trustee shall promptly notify the Company in writing of the Securities selected for redemption and, in the case of any Securities selected for partial redemption, the principal amount thereof to be redeemed.

For all purposes of this Indenture, unless the context otherwise requires, all provisions relating to the redemption of Securities shall relate, in the case of any Securities redeemed or to be redeemed only in part, to the portion of the principal amount of such Securities which has been or is to be redeemed.

SECTION 1104. Notice of Redemption

Notice of redemption shall be given not less than 15 days nor more than 30 days prior to the Redemption Date to each Holder of Securities to be redeemed.

All notices of redemption shall state:

- (i) the Redemption Date;
- (ii) the Redemption Price;
- (iii) if less than all the Outstanding Securities of any series are to be redeemed, the identification (and, in the case of partial redemption, the principal amounts) of the particular Securities to be redeemed;
- (iv) that on the Redemption Date the Redemption Price will become due and payable upon each such Security to be redeemed, and, if applicable, that interest thereon will cease to accrue on and after said date;
- (v) the place or places where such Securities are to be surrendered for payment of the Redemption Price; and
- (vi) that the redemption is for a sinking fund, if such is the case.

Notice of redemption of Securities to be redeemed at the election of the Company shall be given by the Company or, at the Company's request, by the Trustee in the name and at the expense of the Company.

SECTION 1105. Deposit of Redemption Price

On or prior to any Redemption Date, the Company shall deposit with the Trustee or with a Principal Paying Agent (or, if the Company is acting as its own Paying Agent, segregate and hold in trust as provided in Section 1003) an amount of money sufficient to pay the Redemption Price of, and (except if the Redemption Date shall be an Interest Payment Date) accrued interest on, all the Securities that are to be redeemed on that date (to the extent that such amounts are not already on deposit at such time in accordance with the provisions of Sections 401, 403 or 1007).

SECTION 1106. Securities Payable on Redemption Date

Notice of redemption having been given as aforesaid, the Securities so to be redeemed shall, on the Redemption Date, become due and payable at the Redemption Price therein specified, and from and after such date (unless the Company shall default in the payment of the Redemption Price and accrued and unpaid interest) such Securities shall cease to bear interest. Upon surrender of any such Security for redemption in accordance with said notice, such Security shall be paid by the Company at the Redemption Price, together with accrued and unpaid interest to the Redemption Date; *provided, however*, that installments of interest whose Stated Maturity is on or prior to the Redemption Date shall be payable to the Holders of such Securities, or one or more Predecessor Securities, and in the case of Registered Securities, registered as such at the close of business on the relevant Record Dates according to their terms and the provisions of Section 308.

If any Security called for redemption shall not be so paid upon surrender thereof for redemption, the principal (and premium, if any) shall, until paid, bear interest from the Redemption Date at the rate prescribed therefor in the Security.

SECTION 1107. Securities Redeemed in Part

Any Security (including any Global Security) that is to be redeemed only in part shall be surrendered at a Place of Payment therefor (with, if the Company or the Trustee so requires, due endorsement by, or a written instrument of transfer in form satisfactory to the Company and the Trustee duly executed by, the Holder thereof or his attorney duly authorized in writing), and the Company shall execute, and the Trustee upon written direction shall authenticate and deliver to the Holder of such Security without service charge, a new Security or Securities of the same series, of any authorized denomination as requested by such Holder, in aggregate principal amount equal to and in exchange for the unredeemed portion of the principal of the security so surrendered; *provided*, that if a Global Security is so surrendered, the new Global Security shall be in a denomination equal to the unredeemed portion of the principal of the Global Security so surrendered.

SECTION 1108. Optional Redemption in the Event of Change in United Kingdom Tax Treatment

The Company may, at its option, by giving notice as provided in Section 1104, redeem all, but not less than all, of the Securities of any series, at a price equal to the outstanding principal amount thereof, together with accrued and unpaid interest, if any, to the Redemption Date, if:

- (i) the Company satisfies the Trustee prior to the giving of a notice that it has or will become obliged to pay Additional Amounts with respect to the Securities of such series as a result of any change in, or amendment to, the laws or regulations of the United Kingdom or any political subdivision or any authority or agency thereof or therein having power to tax or levy duties, or any change in the application or interpretation of such laws or regulations, which change or amendment becomes effective on or after February 9, 2001; and
- (ii) such obligation cannot be avoided by the Company's taking reasonable measures available to it;

*provided, however*, that no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Company would be obliged to pay such Additional Amounts were a payment in respect of the Company's Securities of such series due.

Prior to the publication of any notice of redemption pursuant to this paragraph, the Company will deliver to the Trustee an Officers' Certificate stating that the obligation referred to in clause (i) above cannot be avoided by the Company's taking reasonable measures available to it, and the Trustee shall accept such certificate as sufficient evidence of the satisfaction of the condition precedent set out in clause (ii) above, in which event it shall be conclusive and binding on the Holders.

## ARTICLE XII

### SINKING FUNDS

SECTION 1201. Applicability of Article

The provisions of this Article shall be applicable to any sinking fund for the retirement of Securities of a series, except as otherwise specified as contemplated by Section 301 for Securities of such series.

The minimum amount of any sinking fund payment provided for by the terms of Securities of any series is herein referred to as a "*mandatory sinking fund payment*," and any payment in excess of such minimum amount provided for by the terms of Securities of any series is herein referred to as an "*optional sinking fund payment*." If provided for by the terms of Securities of any series, the cash amount of any sinking fund payment may be subject to reduction as provided in Section 1202. Each sinking fund payment shall be applied to the redemption of Securities of any series as provided for by the terms of Securities of such series.

SECTION 1202. Satisfaction of Sinking Fund Payments with Securities

In lieu of making all or any part of any mandatory sinking fund payment with respect to any series of Securities in cash, the Company may, at its option, (i) deliver to the Trustee Securities of such series theretofore purchased or otherwise acquired (except upon redemption pursuant to the mandatory sinking fund) by the Company or receive credit for Securities of such series (not previously so credited) theretofore purchased or otherwise acquired (except as aforesaid) by the Company and delivered to the Trustee for cancellation pursuant to Section 310, (ii) receive credit for optional sinking fund payments (not previously so credited) made pursuant to this Section 1202, or (iii) receive credit for Securities of such series (not previously so credited) redeemed by the Company through any optional redemption provision

contained in the terms of such series. Securities so delivered or credited shall be received or credited by the Trustee at the sinking fund Redemption Price specified in such Securities.

**SECTION 1203. Redemption of Securities for Sinking Fund**

Not less than 30 days prior to each sinking fund payment date for any series of Securities, the Company will deliver to the Trustee an Officers' Certificate specifying (i) the amount of the next ensuing sinking fund payment for that series pursuant to the terms of that series, (ii) whether or not the Company intends to exercise its right, if any, to make an optional sinking fund payment with respect to such series on the next ensuing sinking fund payment date and, if so, the amount of such optional sinking fund payment, and (c) the portion thereof, if any, which is to be satisfied by payment of cash and the portion thereof, if any, which is to be satisfied by delivering and crediting Securities of that series pursuant to Section 1202, and will also deliver to the Trustee any Securities to be so delivered. Such written statement shall be irrevocable and, upon its receipt by the Trustee, the Company shall become unconditionally obligated to make all the cash payments or payments therein referred to, if any, on or before the next succeeding sinking fund payment date. Failure of the Company, on or before any such 30<sup>th</sup> day, to deliver such written statement and Securities specified in this paragraph, if any, shall not constitute a default but shall constitute, on and as of such date, the irrevocable election of the Company (A) that the mandatory sinking fund payment for such series due on the next succeeding sinking fund payment date shall be paid entirely in cash without the option to deliver or credit Securities of such series in respect therefor, and (B) that the Company will make no optional sinking fund payment with respect to such series as provided in this Section 1203.

Not less than 30 days before each such sinking fund payment date, the Trustee shall select the Securities to be redeemed upon such sinking fund payment date in the manner specified in Section 1103 and shall cause notice of the redemption thereof to be given in the name of and at the expense of the Company in the manner provided in Section 1104. Such notice having been duly given, the redemption of such Securities shall be made upon the terms and in the manner stated in Sections 1105, 1106, and 1107.

The Trustee shall not redeem or cause to be redeemed any Security of a series with sinking fund moneys or mail any notice of redemption of Securities of such series by operation of the sinking fund during the continuance of a default in payment of interest with respect to Securities of that series or an Event of Default with respect to the Securities of that series, except that, where the mailing of notice of redemption of any Securities shall theretofore have been made, the Trustee shall redeem or cause to be redeemed such Securities, *provided* that it shall have received from the Company a sum sufficient for such redemption. Except as aforesaid, any moneys in the sinking fund for such series at the time when any such default or Event of Default shall occur, and any moneys thereafter paid into the sinking fund, shall, during the continuance of such default or Event of Default, be deemed to have been collected under Article V and be held for the payment of all such Securities. In case such Event of Default shall have been waived as provided in Section 513 or the default or Event of Default cured on or before the 30<sup>th</sup> day preceding the sinking fund payment date, such moneys shall thereafter be applied on the next succeeding sinking fund payment date in accordance with this Section 1203 to the redemption of such Securities.

**ARTICLE XIII**

**MEETINGS OF HOLDERS OF SECURITIES**

**SECTION 1301. Purposes of Meetings**

A meeting of the Holders may be called at any time, from time to time, pursuant to this Article XIII for any of the following purposes:

- (i) to give any notice to the Company or to the Trustee, or to consent to the waiving of any default hereunder and its consequence, or to take any other action authorized to be taken by Holders pursuant to Article IX hereof;
- (ii) to remove the Trustee and appoint a successor trustee pursuant to Article VI hereof; and
- (iii) to consent to the execution of an supplemental indenture hereto pursuant to Section 902 hereof.

**SECTION 1302. Place of Meetings**

(a) The Trustee may at any time (upon not less than 21 days' notice) call a meeting of Holders to be held at such time and at such place as determined by the Trustee. Notice of every meeting of Holders, setting forth the time and the place of such meeting and in general terms the action proposed to be taken at such meeting, shall be mailed to each Holder and published in the manner contemplated by Section 106 hereof.

(b) In case at any time the Company, pursuant to a Board Resolution, or the Holders of at least 10% in aggregate principal amount of the Securities then outstanding, shall have requested the Trustee to call a meeting of the Holders, by written request setting forth in reasonable detail the action proposed to be taken at the meeting, and the Trustee shall not have made the first giving of the notice of such meeting within 20 days after receipt of such request, then the Company or the Holders in the amount above specified may determine the time (not less than 21 days after notice is given) and the place for such meeting, and may call such meeting to take any action authorized in Section 301 hereof by giving notice thereof as provided in Section 1302(a) hereof.

**SECTION 1303. Voting at Meetings**

To be entitled to vote at any meeting of Holders, a Person shall be (i) a Holder or (ii) a Person appointed by an instrument in

writing as proxy for a Holder or Holders by such Holder or Holders. The only Persons who shall be entitled to be present or to speak at any meeting of Holders shall be the Persons so entitled to vote at such meeting and their counsel, any representatives of the Trustee and its counsel, and any representatives of the Company and its counsel.

SECTION 1304. Voting Rights, Conduct and Adjournment

(a) Notwithstanding any other provisions of this Indenture, the Trustee may make such reasonable regulations as it may deem advisable for any meeting of Holders in regard to (i) proof of the holding of Securities of a series and of the appointment of proxies (ii) the appointment and duties of inspectors of votes, the submission and examination of proxies, certificates, and other evidence of the right to vote, and such other matters concerning the conduct of the meeting as it shall deem appropriate. Except as otherwise permitted or required by any such regulations, the holding of Securities of a series shall be proved in the manner specified in Article II hereof, and the appointment of any proxy shall be proved in such manner as is deemed appropriate by the Trustee or by having the signature of the person executing the proxy witnessed or guaranteed by any bank, banker or trust company customarily authorized to certify to the holding of a security such as a Global Security.

(b) At any meeting of Holders, the representative of Persons holding or representing Securities of a series in an aggregate principal amount sufficient under the appropriate provision of this Indenture to take action upon the business for the transaction of which such meeting was called shall constitute a quorum. Any meetings of Holders duly called pursuant to Section 1302 hereof may be adjourned from time to time by vote of the Holders (or proxies for the Holders) of a majority of the Securities of a series represented at the meeting and entitled to vote, whether or not a quorum shall be present; and the meeting may be held as so adjourned without further notice. No action at a meeting of Holders shall be effective unless approved by Persons holding or representing Securities of a series in the aggregate principal amount required by the provision of this Indenture pursuant to which such action is being taken.

(c) At any meeting of Holders, each Holder or proxy shall be entitled to one vote for each \$1,000 principal amount of outstanding Securities of a series held or represented.

SECTION 1305. Revocation of Consent by Holders

At any time prior to (but not after) the evidencing to the Trustee of the taking of any action at a meeting of Holders by the Holders of the percentage in aggregate principal amount of the Securities specified in this Indenture in connection with such action, any Holder of a Security, the serial number of which is included in the Securities the Holders of which have consented to such action, may, by filing written notice with the Trustee at its principal corporate trust office and upon proof of holding as provided herein, revoke such consent so far as concerns such Securities. Except as aforesaid, any such consent given by the Holder of any Securities shall be conclusive and binding upon such Holder and upon all future Holders and owners of such Securities and of any Securities issued in exchange therefor, in lieu thereof or upon transfer thereof, irrespective of whether or not any notation in regard thereto is made upon such Securities. Any action taken by the Holders of the percentage in aggregate principal amount of the Holders specified in this Indenture in connection with such action shall be conclusively binding upon the Company, the Trustee, and the Holders of all the Securities.

ARTICLE XIV

MISCELLANEOUS

SECTION 1401. Consent to Jurisdiction; Appointment of Agent to Accept Service of Process

(a) The Company irrevocably consents and agrees, for the benefit of the Holders from time to time of the Securities and the Trustee, that any legal action, suit or proceeding against it with respect to its obligations, liabilities or any other matter arising out of or in connection with this Indenture or the Securities may be brought in the Supreme Court of New York, New York County or the United States District Court for the Southern District of New York and any appellate court from either thereof and, until amounts due and to become due in respect of the Securities have been paid, hereby irrevocably consents and submits to the nonexclusive jurisdiction of each such court in *personam*, generally and unconditionally with respect to any action, suit or proceeding for itself and in respect of its properties, assets, and revenues.

(b) The Company has irrevocably designated, appointed, and empowered CT Corporation System, as its designee, appointee, and agent to receive, accept, and acknowledge for and on its behalf, and its properties, assets, and revenues, service of any and all legal process, summons, notices, and documents that may be served in any action, suit or proceeding brought against the Company in any United States or State court. If for any reason such designee, appointee, and agent hereunder shall cease to be available to act as such, the Company agrees to designate a new designee, appointee, and agent in the Borough of Manhattan, The City of New York on the terms and for the purposes of this Section 1401 satisfactory to the Trustee. The Company further hereby irrevocably consents and agrees to the service of any and all legal process, summons, notices, and documents in any action, suit or proceeding against the Company by serving a copy thereof upon the relevant agent for service of process referred to in this Section 1401 (whether or not the appointment of such agent shall for any reason prove to be ineffective or such agent shall accept or acknowledge such service) or by mailing copies thereof by registered or certified air mail, postage prepaid, to the Company at its address specified in or designated pursuant to this Indenture. The Company agrees that the failure of any such designee, appointee, and agent to give any notice of such service to it shall not impair or affect in any way the validity of such service or any judgment rendered in any action or proceeding based thereon. Nothing herein shall in any way be deemed to limit the ability of the Holders of the Securities and the Trustee, to serve any such legal process, summons, notices, and documents in any other manner permitted by applicable law or to obtain jurisdiction over the Company or bring actions, suits or proceedings against the Company in such other jurisdictions, and in such manner, as may be permitted by applicable law. The Company irrevocably and unconditionally waives, to the fullest extent permitted by law, any objection which it may now or hereafter have to the laying of venue of any of the aforesaid actions, suits or

proceedings arising out of or in connection with this Indenture brought in the Supreme Court of New York, New York County or the United States District Court for the Southern District of New York and any appellate court from either thereof and hereby further irrevocably and unconditionally waives and agrees not to plead or claim in any such court that any such action, suit or proceeding brought in any such court has been brought in an inconvenient forum.

If for the purpose of obtaining judgment in any court it is necessary to convert a sum due hereunder to the holder of any Security from U.S. dollars into another currency, the Company has agreed, and each Holder by holding such Security will be deemed to have agreed, to the fullest extent that they may effectively do so, that the rate of exchange used shall be that at which in accordance with normal banking procedures such Holder could purchase U.S. dollars with such other currency in The City of New York on the Business Day preceding the day on which final judgment is given.

The obligation of the Company in respect of any sum payable by it to the Holder of a Security shall, notwithstanding any judgment in a currency (the "*judgment currency*") other than U.S. dollars, be discharged only to the extent that on the Business Day following receipt by the Holder of such Security of any sum, adjudged to be so due in the judgment currency, the Holder of such Security may in accordance with normal banking procedures purchase U.S. dollars with the judgment currency; if the amount of U.S. dollars so purchased is less than the sum originally due to the Holder of such Security in the judgment currency (determined in the manner set forth in the preceding paragraph), the Company agrees, as a separate obligation and notwithstanding any such judgment, to indemnify the Holder of such Security against such loss, and if the amount of the U.S. dollars so purchased exceeds the sum originally due to the Holder of such Security, such Holder agrees to remit to the Company such excess; *provided* that such Holder shall have no obligation to remit any such excess as long as the Company shall have failed to pay such Holder any obligations due and payable under such Security, in which case such excess may be applied to such obligations of the Company under such Security in accordance with the terms thereof.

SECTION 1402. Counterparts

This instrument may be executed in any number of counterparts, each of which so executed shall be deemed to be an original, but all such counterparts shall together constitute but one and the same instrument.

**[Remainder of page intentionally left blank.]**

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IN WITNESS WHEREOF, the parties hereto have caused this Indenture to be duly executed by their respective officers or directors duly authorized thereto, all as of the day and year first above written.

WPD HOLDINGS UK

By \_\_\_\_\_  
Title: \_\_\_\_\_

Attest:

\_\_\_\_\_

BANKERS TRUST COMPANY, as Trustee, Principal Paying Agent, Security Registrar and Transfer Agent

By \_\_\_\_\_  
Title: \_\_\_\_\_

Attest:

\_\_\_\_\_

DEUTSCHE BANK LUXEMBOURG S.A., as Paying Agent and Transfer Agent

By \_\_\_\_\_  
Title: \_\_\_\_\_



## PPL CORPORATION AND SUBSIDIARIES

COMPUTATION OF RATIO OF EARNINGS TO COMBINED FIXED CHARGES AND  
PREFERRED STOCK DIVIDENDS

(Millions of Dollars)

	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Earnings, as defined:					
Income from Continuing Operations Before Income Taxes	\$ 596	\$ 1,357	\$ 1,281	\$ 1,099	\$ 780
Less earnings of equity method investments	2	1	3	4	5
Distributed income from equity method investments	2	1	5	3	5
	<u>596</u>	<u>1,357</u>	<u>1,283</u>	<u>1,098</u>	<u>780</u>
Total fixed charges as below	513	568	609	559	569
Less:					
Capitalized interest and interest component of AFUDC	45	59	58	24	9
Preferred security distributions of subsidiaries on a pre-tax basis	24	27	23	24	5
Interest expense related to discontinued operations	5	8	33	36	37
Total fixed charges included in Income from Continuing Operations Before Income Taxes	<u>439</u>	<u>474</u>	<u>495</u>	<u>475</u>	<u>518</u>
Total earnings	<u>\$ 1,035</u>	<u>\$ 1,831</u>	<u>\$ 1,778</u>	<u>\$ 1,573</u>	<u>\$ 1,298</u>
Fixed charges, as defined:					
Interest on long-term debt	\$ 397	\$ 478	\$ 522	\$ 482	\$ 480
Interest on short-term debt and other interest	34	28	35	13	29
Amortization of debt discount, expense and premium - net	15	12	8	11	23
Estimated interest component of operating rentals	42	22	21	29	32
Preferred securities distributions of subsidiaries on a pre-tax basis	24	27	23	24	5
Fixed charges of majority-owned share of 50% or less-owned persons	1	1			
Total fixed charges (a)	<u>\$ 513</u>	<u>\$ 568</u>	<u>\$ 609</u>	<u>\$ 559</u>	<u>\$ 569</u>
Ratio of earnings to fixed charges	<u>2.0</u>	<u>3.2</u>	<u>2.9</u>	<u>2.8</u>	<u>2.3</u>
Ratio of earnings to combined fixed charges and preferred stock dividends (b)	<u>2.0</u>	<u>3.2</u>	<u>2.9</u>	<u>2.8</u>	<u>2.3</u>

(a) Interest on unrecognized tax benefits is not included in fixed charges.

(b) PPL, the parent holding company, does not have any preferred stock outstanding; therefore, the ratio of earnings to combined fixed charges and preferred stock dividends is the same as the ratio of earnings to fixed charges.

## PPL ENERGY SUPPLY, LLC AND SUBSIDIARIES

COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES  
(Millions of Dollars)

	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Earnings, as defined:					
Income from Continuing Operations Before Income Taxes	\$ 334	\$ 1,085	\$ 1,095	\$ 841	\$ 619
Less earnings of equity method investments	2	1	3	5	5
Distributed income from equity method investments	2	1	5	3	5
	<u>334</u>	<u>1,085</u>	<u>1,097</u>	<u>839</u>	<u>619</u>
Total fixed charges as below	364	390	388	326	307
Less:					
Capitalized interest	44	57	54	21	7
Interest expense related to discontinued operations	5	4	27	30	31
Total fixed charges included in Income from Continuing Operations Before Income Taxes	<u>315</u>	<u>329</u>	<u>307</u>	<u>275</u>	<u>269</u>
Total earnings	<u>\$ 649</u>	<u>\$ 1,414</u>	<u>\$ 1,404</u>	<u>\$ 1,114</u>	<u>\$ 888</u>
Fixed charges, as defined:					
Interest on long-term debt	\$ 284	\$ 345	\$ 353	\$ 296	\$ 259
Interest on short-term debt and other interest	29	27	24	16	26
Amortization of debt discount, expense and premium - net	8	2	(3)	(1)	7
Estimated interest component of operating rentals	42	15	14	15	15
Fixed charges of majority-owned share of 50% or less-owned persons	<u>1</u>	<u>1</u>			
Total fixed charges (a)	<u>\$ 364</u>	<u>\$ 390</u>	<u>\$ 388</u>	<u>\$ 326</u>	<u>\$ 307</u>
Ratio of earnings to fixed charges	<u>1.8</u>	<u>3.6</u>	<u>3.6</u>	<u>3.4</u>	<u>2.9</u>

(a) Interest on unrecognized tax benefits is not included in fixed charges.

## PPL ELECTRIC UTILITIES CORPORATION AND SUBSIDIARIES

COMPUTATION OF RATIO OF EARNINGS TO COMBINED FIXED CHARGES AND  
PREFERRED STOCK DIVIDENDS

(Millions of Dollars)

	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Earnings, as defined:					
Income Before Income Taxes	\$ 221	\$ 278	\$ 246	\$ 298	\$ 216
Total fixed charges as below	121	114	143	159	190
Less interest component of AFUDC	<u>2</u>	<u>2</u>	<u>3</u>	<u>1</u>	<u></u>
Total fixed charges included in Income Before Income Taxes	<u>119</u>	<u>112</u>	<u>140</u>	<u>158</u>	<u>190</u>
Total earnings	<u>\$ 340</u>	<u>390</u>	<u>\$ 386</u>	<u>\$ 456</u>	<u>\$ 406</u>
Fixed charges, as defined:					
Interest on long-term debt	\$ 105	94	\$ 109	\$ 131	\$ 151
Interest on short-term debt and other interest	9	13	23	13	22
Amortization of debt discount, expense and premium - net	6	6	7	8	9
Estimated interest component of operating rentals	<u>1</u>	<u>1</u>	<u>4</u>	<u>7</u>	<u>8</u>
Total fixed charges (a)	<u>\$ 121</u>	<u>\$ 114</u>	<u>\$ 143</u>	<u>\$ 159</u>	<u>\$ 190</u>
Ratio of earnings to fixed charges	<u>2.8</u>	<u>3.4</u>	<u>2.7</u>	<u>2.9</u>	<u>2.1</u>
Preferred stock dividend requirements on a pre-tax basis	\$ 28	\$ 28	\$ 27	\$ 24	\$ 4
Fixed charges, as above	<u>121</u>	<u>114</u>	<u>143</u>	<u>159</u>	<u>190</u>
Total fixed charges and preferred stock dividends	<u>\$ 149</u>	<u>\$ 142</u>	<u>\$ 170</u>	<u>\$ 183</u>	<u>\$ 194</u>
Ratio of earnings to combined fixed charges and preferred stock dividends	<u>2.3</u>	<u>2.7</u>	<u>2.3</u>	<u>2.5</u>	<u>2.1</u>

(a) Interest on unrecognized tax benefits is not included in fixed charges.

**PPL Corporation**  
**Subsidiaries of the Registrant**  
**At December 31, 2009**

<b>Company Name</b> <b>Business Conducted under Same Name</b>	<b>State or Jurisdiction of</b> <b>Incorporation/Formation</b>
PPL Electric Utilities Corporation	Pennsylvania
PPL Energy Funding Corporation	Pennsylvania
PPL Energy Supply, LLC	Delaware
PPL Investment Corporation	Delaware
PPL Global, LLC	Delaware
PMDC International Holdings, Inc.	Delaware
PPL EnergyPlus, LLC	Pennsylvania
PPL Generation, LLC	Delaware
PPL Susquehanna, LLC	Delaware
PPL UK Holdings, LLC	Delaware
PPL UK Resources Limited	United Kingdom
Western Power Distribution Holdings Limited	United Kingdom
PPL Montana Holdings, LLC	Delaware
PPL Montana, LLC	Delaware

**PPL Electric Utilities Corporation  
Subsidiaries of the Registrant  
At December 31, 2009**

Exhibit 21(b)

**Company Name  
Business Conducted under Same Name** \_\_\_\_\_

**State or Jurisdiction of  
Incorporation/Formation** \_\_\_\_\_

None that are required to be reported.

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in PPL Corporation's Registration Statement on Form S-3 No. 333-158200, the Registration Statement on Form S-3D No 333-161826, and the Registration Statements on Form S-8 (Nos. 333-02003, 333-112453, 333-110372, 333-95967 and 333-144047) of our reports dated February 25, 2010, with respect to the consolidated financial statements of PPL Corporation and the effectiveness of internal control over financial reporting of PPL Corporation, included in this Annual Report (Form 10-K) for the year ended December 31, 2009.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania  
February 25, 2010

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in PPL Energy Supply, LLC's Registration Statement on Form S-3 No. 333-158200-02 of our report dated February 25, 2010, with respect to the consolidated financial statements of PPL Energy Supply, LLC, included in this Annual Report (Form 10-K) for the year ended December 31, 2009.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania  
February 25, 2010

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in PPL Electric Utilities Corporation's Registration Statement on Form S-3 No. 333-158200-01 of our report dated February 25, 2010, with respect to the consolidated financial statements of PPL Electric Utilities Corporation, included in this Annual Report (Form 10-K) for the year ended December 31, 2009.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania  
February 25, 2010



PPL CORPORATION  
2009 ANNUAL REPORT  
TO THE SECURITIES AND EXCHANGE COMMISSION  
ON FORM 10-K

POWER OF ATTORNEY

The undersigned directors of PPL Corporation, a Pennsylvania corporation, that is to file with the Securities and Exchange Commission, Washington, D.C., under the provisions of the Securities Exchange Act of 1934, as amended, its Annual Report on Form 10-K for the year ended December 31, 2009 ("Form 10-K Report"), do hereby appoint each of James H. Miller, Paul A. Farr, Robert J. Grey and Michael A. McGrail, and each of them, their true and lawful attorney, with power to act without the other and with full power of substitution and resubstitution, to execute for them and in their names the Form 10-K Report and any and all amendments thereto, whether said amendments add to, delete from or otherwise alter the Form 10-K Report, or add or withdraw any exhibits or schedules to be filed therewith and any and all instruments in connection therewith. The undersigned hereby grant to each said attorney full power and authority to do and perform in the name of and on behalf of the undersigned, and in any and all capacities, any act and thing whatsoever required or necessary to be done in and about the premises, as fully and to all intents and purposes as the undersigned might do, hereby ratifying and approving the acts of each of the said attorneys.

IN WITNESS WHEREOF, the undersigned have hereunto set their hands this 25th day of February, 2010.

/s/ Frederick M. Bernthal  
Frederick M. Bernthal

/s/ John W. Conway  
John W. Conway

/s/ E. Allen Deaver  
E. Allen Deaver

/s/ Louise K. Goeser  
Louise K. Goeser

/s/ Stuart E. Graham  
Stuart E. Graham

/s/ Stuart Heydt  
Stuart Heydt

/s/ James H. Miller  
James H. Miller

/s/ Craig A. Rogerson  
Craig A. Rogerson

/s/ W. Keith Smith  
W. Keith Smith

/s/ Natica von Althann  
Natica von Althann

/s/ Keith H. Williamson  
Keith H. Williamson

CERTIFICATION

JAMES H. MILLER, certify that:

1. I have reviewed this annual report on Form 10-K of PPL Corporation ("the registrant") for the year ended December 31, 2009;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 25, 2010

/s/ James H. Miller  
James H. Miller  
Chairman, President and Chief Executive Officer  
PPL Corporation

CERTIFICATION

PAUL A. FARR, certify that:

1. I have reviewed this annual report on Form 10-K of PPL Corporation ("the registrant") for the year ended December 31, 2009;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 25, 2010

/s/ Paul A. Farr  
Paul A. Farr  
Executive Vice President and Chief Financial Officer  
PPL Corporation

CERTIFICATION

^ JAMES H. MILLER, certify that:

1. I have reviewed this annual report on Form 10-K of PPL Energy Supply, LLC (the "registrant") for the year ended December 31, 2009;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 25, 2010

/s/ James H. Miller  
James H. Miller  
President  
PPL Energy Supply, LLC

CERTIFICATION

PAUL A. FARR, certify that:

1. I have reviewed this annual report on Form 10-K of PPL Energy Supply, LLC (the "registrant") for the year ended December 31, 2009;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 25, 2010

/s/ Paul A. Farr  
Paul A. Farr  
Executive Vice President  
PPL Energy Supply, LLC

CERTIFICATION

I, DAVID G. DECAMPLI, certify that:

1. I have reviewed this annual report on Form 10-K of PPL Electric Utilities Corporation (the "registrant") for the year ended December 31, 2009;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 25, 2010

/s/ David G. DeCampli

David G. DeCampli

President

PPL Electric Utilities Corporation

CERTIFICATION

J. MATT SIMMONS, JR., certify that:

1. I have reviewed this annual report on Form 10-K of PPL Electric Utilities Corporation (the "registrant") for the year ended December 31, 2009;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 25, 2010

/s/ J. Matt Simmons, Jr.

J. Matt Simmons, Jr.  
Vice President and Controller  
PPL Electric Utilities Corporation

CERTIFICATE PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
FOR PPL CORPORATION'S 10-K FOR THE YEAR ENDED DECEMBER 31, 2009

In connection with the annual report on Form 10-K of PPL Corporation (the "Company") for the year ended December 31, 2009, as filed with the Securities and Exchange Commission on the date hereof (the "Covered Report"), I, the principal executive officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that:

- The Covered Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- The information contained in the Covered Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 25, 2010

/s/ James H. Miller

James H. Miller  
Chairman, President and Chief Executive Officer  
PPL Corporation

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.



CERTIFICATE PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
FOR PPL CORPORATION'S 10-K FOR THE YEAR ENDED DECEMBER 31, 2009

In connection with the annual report on Form 10-K of PPL Corporation (the "Company") for the year ended December 31, 2009, as filed with the Securities and Exchange Commission on the date hereof (the "Covered Report"), I, the principal financial officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that:

- The Covered Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- The information contained in the Covered Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 25, 2010

/s/ Paul A. Farr

Paul A. Farr  
Executive Vice President and  
Chief Financial Officer  
PPL Corporation

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATE PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
FOR PPL ENERGY SUPPLY, LLC'S 10-K FOR THE YEAR ENDED DECEMBER 31, 2009

In connection with the annual report on Form 10-K of PPL Energy Supply, LLC (the "Company") for the year ended December 31, 2009, as filed with the Securities and Exchange Commission on the date hereof (the "Covered Report"), I, the principal executive officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that:

- The Covered Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- The information contained in the Covered Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 25, 2010

/s/ James H. Miller

James H. Miller  
President  
PPL Energy Supply, LLC

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATE PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
FOR PPL ENERGY SUPPLY, LLC'S 10-K FOR THE YEAR ENDED DECEMBER 31, 2009

In connection with the annual report on Form 10-K of PPL Energy Supply, LLC (the "Company") for the year ended December 31, 2009, as filed with the Securities and Exchange Commission on the date hereof (the "Covered Report"), I, the principal financial officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that:

- The Covered Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- The information contained in the Covered Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 25, 2010

/s/ Paul A. Farr

Paul A. Farr  
Executive Vice President  
PPL Energy Supply, LLC

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATE PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
FOR PPL ELECTRIC UTILITIES CORPORATION'S 10-K FOR THE YEAR ENDED DECEMBER 31, 2009

In connection with the annual report on Form 10-K of PPL Electric Utilities Corporation (the "Company") for the year ended December 31, 2009, as filed with the Securities and Exchange Commission on the date hereof (the "Covered Report"), I, the principal executive officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that:

- The Covered Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- The information contained in the Covered Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 25, 2010

/s/ David G. DeCampli

David G. DeCampli

President

PPL Electric Utilities Corporation

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

CERTIFICATE PURSUANT TO 18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002  
FOR PPL ELECTRIC UTILITIES CORPORATION'S 10-K FOR THE YEAR ENDED DECEMBER 31, 2009

In connection with the annual report on Form 10-K of PPL Electric Utilities Corporation (the "Company") for the year ended December 31, 2009, as filed with the Securities and Exchange Commission on the date hereof (the "Covered Report"), I, the principal financial officer of the Company, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, hereby certify that:

- The Covered Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- The information contained in the Covered Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 25, 2010

/s/ J. Matt Simmons, Jr.

J. Matt Simmons, Jr.  
Vice President and Controller  
PPL Electric Utilities Corporation

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

**Examples of Wholesale Energy, Fuel and Emission Allowance Price Fluctuations  
2005 through 2009**

**Wholesale Energy:****PJM West Hub\* Power Price - \$/MWh**

Year	High	Month	Low	Month
2005	\$ 315.65	July	\$ 0.00**	Jan., April, May, June, July, Sept.
2006	\$ 769.90	August	\$ 0.00**	April, May, June, July, Aug., Nov., Dec.
2007	\$ 571.60	August	\$ 0.00**	May, June, July, Sept.
2008	\$ 475.58	June	\$ 0.00**	May, July, Aug., Sept.
2009	\$ 246.61	February	\$ 0.00**	March, May, June, July, Aug., Sept.

\* A common trading hub for PJM.

\*\* Occurs during times of low demand for electricity when generation levels of generating units are reduced to their normal minimums.

**Mid-C\* Power Price - \$/MWh**

Year	High	Month	Low	Month
2005	\$ 139.76	December	\$ 7.68	May
2006	\$ 189.87	July	\$ (2.00)**	May
2007	\$ 197.79	July	\$ 0.86	March
2008	\$ 101.29	April	\$ (7.50)**	June
2009	\$ 111.53	December	\$ 0.28	June

\* A common trading hub for Northwestern U.S.

\*\* Occurs when generation levels from hydroelectric units exceed demand due to excess water runoff.

**Fuel:****NYMEX Coal (1% sulfur content, 12,000 Btu) Price - \$/ton**

Year	High	Month	Low	Month
2005	\$ 62.75	September	\$ 51.10	June
2006	\$ 57.75	February	\$ 37.50	November
2007	\$ 56.80	November	\$ 38.75	January
2008	\$ 143.25	July	\$ 56.17	January
2009	\$ 68.25	January	\$ 42.25	April

**NYMEX Natural Gas Price - \$/million Btu**

Year	High	Month	Low	Month
2005	\$ 15.38	December	\$ 5.83	January
2006	\$ 10.63	January	\$ 4.20	September
2007	\$ 9.90	May	\$ 5.20	September
2008	\$ 13.69	August	\$ 5.28	December
2009	\$ 6.24	February	\$ 2.41	October

**Residual Oil (1% sulfur content) Price @ NY Harbor - \$/barrel**

Year	High	Month	Low	Month
2005	\$ 54.38	October	\$ 26.88	January
2006	\$ 54.25	April	\$ 35.00	October
2007	\$ 72.52	December	\$ 37.23	January
2008	\$ 119.70	July	\$ 28.40	December
2009	\$ 44.95	December	\$ 33.70	March

**Sulfur Dioxide Emission Allowances:****SO2 Emission Allowance Price - \$/allowance**

Year	High	Month	Low	Month
2005	\$ 1,610	December	\$ 640	January
2006	\$ 1,598	January	\$ 445	November
2007	\$ 715	June	\$ 405	January
2008	\$ 535	January	\$ 88	July
2009	\$ 215	January	\$ 56	April