EAST KENTUCKY POWER COOPERATIVE

March 19, 2007

HAND DELIVERED

Ms. Elizabeth O'Donnell
Executive Director
Public Service Commission
211 Sower Boulevard
Frankfort, KY 40602

RECEIVED
MAR 19 2007
PUBLIC SERVICE COMMISSION

Re: PSC Case No. 2006-00472

Dear Ms. O'Donnell:

Please find enclosed for filing with the Commission in the above-referenced case an original and ten copies of the draft financial statements of East Kentucky Power Cooperative, Inc. ("EKPC"), for the year ended December 31, 2006. These financial statements are being filed in response to the reference in the Commission's order in this case dated March 16, 2007, and are relevant to the issues involved in the hearing in this case scheduled for March 22, 2007. EKPC anticipates no significant changes to these financial statements; however, they must be designated as draft statements until the auditor executes the final audit opinion, and the statements are accepted by the EKPC Board of Directors in April. Once the final audited financial statements are available, they will be filed with the Commission.

Very truly yours,

Charles A. Lile

Charles A. Lile
Senior Corporate Counsel

Enclosures

Cc: Parties of Record

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P.O. Box 707, Winchester,
Kentucky 40392-0707

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COMMISSION

EAST KENTUCKY POWER COOPERATIVE, INC.
AND SUBSIDIARY

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2006 and 2005

EAST KENTUCKY POWER COOPERATIVE, INC.
AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

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December 31, 2006 and 2005
(Dollars in Thousands)

	2006	2005
ASSETS		
Electric plant, at original cost		
In-service	$ 2,079,932	$ 2,039,674
Construction in progress	402,387	152,585
	2,482,319	2,192,259
Less accumulated depreciation	798,533	774,996
Electric plant, net	1,683,786	1,417,263
Long-term accounts receivable	8,572	9,002
Investment securities		
Available for sale	43,956	42,581
Held to maturity	8,216	8,237
Current assets		
Cash and cash equivalents	69,202	43,863
Accounts receivable	62,091	77,663
Fuel	44,682	39,236
Materials and supplies	37,129	33,578
Emission allowances	58,920	4,087
Other	1,986	1,769
Total current assets	274,010	200,196
Deferred charges	4,499	4,751
Other	7,053	5,864
Total assets	$ 2,030,092	$ 1,687,894
LIABILITIES AND MEMBERS' EQUITIES		
Members' equities	$ 107,033	$ 96,108
Long-term debt, excluding current portion	1,643,305	1,339,263
Current liabilities		
Current portion of long-term debt	57,782	53,085
Accounts payable	90,977	75,855
Accrued expenses	23,846	20,101
Total current liabilities	172,605	149,041
Accrued postretirement benefit cost	48,663	46,604
Other	58,486	56,878
Total liabilities and members' equities	$ 2,030,092	$ 1,687,894

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

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EAST KENTUCKY POWER COOPERATIVE, INC.
AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF REVENUE AND EXPENSES
Years Ended December 31, 2006 and 2005
(Dollars in Thousands)

	2006	2005
Operating revenue	$ 650,960	$ 631,297
Operating expenses		
Production		
Fuel	278,210	263,434
Other	113,382	103,632
Purchased power	76,781	109,571
Transmission and distribution	27,557	21,029
Depreciation	39,384	52,038
General and administrative	38,436	38,642
	573,750	588,346
Operating margins	77,210	42,951
Interest expense	84,834	69,844
Net operating deficit	(7,624)	(26,893)
Nonoperating margins		
Interest income	8,433	5,898
Allowance for interest on borrowed funds used during construction	9,192	6,226
Assessments	-	(32,555)
Miscellaneous	858	742
	18,483	(19,689)
Capital credits and patronage capital allocations	315	575
Net margin (deficit)	$ 11,174	$ (46,007)

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

EAST KENTUCKY POWER COOPERATIVE, INC.
AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN MEMBERS' EQUITIES

Years Ended December 31, 2006 and 2005

(Dollars in Thousands)

	Memberships	Patronage Capital	Donated Capital	Accumulated Other Comprehensive Income	Total Members' Equities
Balances, January 1, 2005	$ 2	$ 138,393	$ 3,035	$ 620	$ 142,050
Comprehensive loss					
Net deficit	-	(46,007)	-	-	(46,007)
Unrealized gains on investments available for sale	-	-	-	65	65
Total comprehensive loss					(45,942)
Balances, December 31, 2005	2	92,386	3,035	685	96,108
Comprehensive income					
Net margin	-	11,174	-	-	11,174
Unrealized losses on investments available for sale	-	-	-	(249)	(249)
Total comprehensive income					10,925
Balances, December 31, 2006	$ 2	$ 103,560	$ 3,035	$ 436	$ 107,033

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

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**EAST KENTUCKY POWER COOPERATIVE, INC.
AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS**
Years Ended December 31, 2006 and 2005
(Dollars in Thousands)

	2006	2005
Cash flows from operating activities		
Net margin (deficit)	$ 11,174	$ (46,007)
Adjustments to reconcile net deficit to net cash from operating activities		
Depreciation	39,384	52,038
Amortization of loan costs	2,843	1,418
Changes in:		
Accounts receivable	15,572	(21,156)
Fuel	(19,237)	(21,158)
Materials and supplies	(4,034)	(6,206)
Emission allowances	(54,833)	(3,888)
Accounts payable, trade	43,810	42,630
Accrued expenses	3,745	3,980
Accrued postretirement benefit cost	2,059	1,972
Other	(18,236)	33,669
Net cash from operating activities	22,247	37,292
Cash flows from investing activities		
Additions to electric plant	(304,474)	(190,277)
Maturities and calls of securities available for sale	57,785	79,465
Purchases of securities available for sale	(59,409)	(82,278)
Maturities of securities held to maturity	21	14,311
Payments received on long-term accounts receivable	430	799
Net cash from investing activities	(305,647)	(177,980)
Cash flows from financing activities		
Proceeds from long-term debt	360,000	345,132
Principal payments on long-term debt	(51,261)	(220,691)
Net cash from financing activities	308,739	124,441
Net change in cash and cash equivalents	25,339	(16,247)
Cash and cash equivalents at beginning of year	43,863	60,110
Cash and cash equivalents at end of year	$ 69,202	$ 43,863

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

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EAST KENTUCKY POWER COOPERATIVE, INC.
AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2006 and 2005
(Dollars in Thousands)

	2006	2005
Supplemental disclosure of cash flow information		
Cash paid for interest	$ 82,183	$ 65,925
Non-cash operating transaction		
Fuel included in accounts payable	$ 13,791	$ 18,434
Materials and supplies included in accounts payable	483	-
Non-cash investing transaction		
Additions to electric plant included in accounts payable	$ 14,414	$ 23,332
Unrealized (losses) gains on securities available for sale	(249)	65

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

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations: The Cooperative is engaged in generating and transmitting electrical power primarily to its sixteen member cooperatives throughout central and eastern Kentucky. The financial statements are prepared in accordance with policies prescribed or permitted by the Kentucky Public Service Commission (KPSC) and the United States Department of Agriculture, Rural Utilities Service (RUS), which conform with accounting principles generally accepted in the United States of America as applied to regulated enterprises.

Principles of Consolidation: The consolidated financial statements include the accounts of East Kentucky Power Cooperative, Inc. and its subsidiary, Charleston Bottoms Rural Electric Cooperative Corporation (CBRECC). All significant intercompany accounts and transactions have been eliminated.

Estimates in the Financial Statements: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and 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.

Electric Plant: Electric plant is stated at original cost, which is the cost when first dedicated to public service, including applicable labor and overhead cost and an allowance for interest on borrowed funds used during construction.

The cost of maintenance and repairs, including renewals of minor items of property, is charged to operating expense. The cost of replacement of depreciable property units, as distinguished from minor items, is charged to utility plant. The cost of units replaced or retired, including cost of removal, net of any salvage value, is charged to accumulated depreciation.

Provision for depreciation has been made on the basis of estimated useful lives at straight-line composite rates or end dates generally as follows:

Production plant	years 2019 - 2045
Transmission and distribution plant	0.71% - 3.42%
General plant	2.00% - 20.00%

Long-Term Assets: Electric plant and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value. No impairment has been recognized on long-term assets for the years ended December 31, 2006 or 2005.

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Interest on Borrowed Funds Used During Construction: In accordance with practices permitted by the prescribed system of accounts, the Cooperative provides an allowance for interest on borrowed funds used during construction. The allowance represents the calculated net interest cost of funds borrowed for construction of major projects which take longer than one year and cost in excess of $100,000.

Investment Securities: Investment securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Investment securities are classified as available for sale when they might be sold before maturity. Investment securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income. Trading securities are carried at fair value, with changes in unrealized holding gains and losses included in income.

Interest income includes amortization of purchase premium or discount. Gains and losses on sales are based on the amortized cost of the security sold. Investment securities are written down to fair value when a decline in fair value is not temporary.

Revenue and Fuel Costs: Revenue is recorded monthly based on meter readings made at month-end.

The state regulatory authority has adopted a uniform fuel adjustment clause for all electric utilities within its jurisdiction. Under this clause, fuel cost above or below a stated amount per kWh is charged or credited to the member cooperatives for all energy sales.

In September 2004, the Cooperative applied to the KPSC for the recovery of certain costs incurred in compliance with the Federal Clean Air Act. This environmental surcharge was effective for service rendered on or after July 1, 2005, and is being billed on a percentage of revenue basis.

The Cooperative's sales are primarily to its member cooperatives and amounted to approximately $645,476,000 and $620,509,000 for 2006 and 2005, respectively. Accounts receivable at December 31, 2006 and 2005 were primarily from billings to member cooperatives. At December 31, 2006 and 2005, individual account balances that exceeded 10 percent of total accounts receivable are as follows:

	2006	2005
Owen Electric Cooperative	$ 8,748,000	$10,137,000
South Kentucky RECC	6,408,000	-
Blue Grass Energy Cooperative	6,304,000	-

(Continued)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash and Cash Equivalents: For purposes of the consolidated financial statements, the Cooperative considers temporary investments having a maturity of three months or less when purchased to be cash equivalents.

At December 31, 2006 and 2005, respectively, the Cooperative had $1,205,394 and $674,661 of cash on deposit at one bank, which is in excess of federally insured limits.

Fuel and Materials and Supplies: Inventories of fuels and materials and supplies are stated at average cost.

Emission Allowances: Title IV of the Clean Air Act Amendments of 1990 provides for the issuance of allowances as a means to limit the emissions of certain airborne pollutants. Allowances are stated at cost. Issuances of allowances are recognized using a monthly weighted-average method of cost determination. Gains and losses are recorded upon the disposition of allowances.

Members' Equities: Memberships represent contributions to the Cooperative made by members. Should the Cooperative cease business, these amounts, if available, will be returned to the members. In addition, any available capital credits will also be allocated to members on a contribution-to-gross margins basis.

A provision in the Cooperative's bylaws prohibits the return of capital contributed by patrons unless, after any proposed retirement, the total capital of the Cooperative equals or exceeds 40 percent of total assets. In addition, provisions of certain loan agreements prohibit the retirement of capital until stipulated requirements as to liquid assets (cash and U.S. Government obligations) are met. Accordingly, at December 31, 2006, no patronage capital was available for refunds or retirement.

Comprehensive Income: Comprehensive income includes both net margin (deficit) and other comprehensive income. Other comprehensive income represents the change in unrealized gains and losses on securities available for sale.

Income Taxes: The Cooperative is exempt under section 501(c)(12) of the Internal Revenue Code from federal income tax for any year in which at least 85 percent of its gross income is derived from members but is responsible for income taxes on certain unrelated business income.

Reclassifications: Certain 2005 amounts have been reclassified in these consolidated financial statements to conform to the 2006 presentation. Such reclassifications had no effect on net deficit or members' equities as previously presented.

(Continued)

NOTE 2 - ELECTRIC PLANT

Electric plant in-service consisted of the following:

	2006	2005
	(in thousands)	
Production plant	$ 1,558,660	$ 1,141,340
Transmission plant	432,580	409,889
General plant	68,517	69,724
Completed construction, not classified and other	20,175	418,721
Electric plant in service	$ 2,079,932	$ 2,039,674

Depreciation expense was $39,384,000 and $52,038,000 for 2006 and 2005, respectively.

As required by the KPSC environmental surcharge order (addressed in Note 1), the Cooperative engaged an outside firm to conduct a depreciation study. As a result, useful lives of production plant were extended, and rates on transmission and distribution plant were changed. These changes in estimated useful lives reduced 2006 depreciation expense by approximately $16.1 million.

NOTE 3 - LONG-TERM ACCOUNTS RECEIVABLE

Long-term receivables include modifications to Spurlock Power Station in order to provide steam to a paper mill that recycles container board. The paper mill is reimbursing the Cooperative for the cost of the modifications through a monthly facilities charge over the 20-year life of the contract. Long-term receivables also include interest-bearing notes from joint ventures owned by the Cooperative and four of the Cooperative's member systems for the buyout of a propane company. The joint ventures of the member systems will make five years of interest-only (prime rate minus one-half of one percent, adjust annually) payments, with principal and interest payments beginning in 2005. The notes will be payable in full in 2015.

(Continued)

NOTE 4 - INVESTMENT SECURITIES

Amortized cost and estimated fair value of investment securities available for sale at December 31 are as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2006				
National Rural Utilities Cooperative Finance Corporation Promissory Note	$ 24	$ -	$ -	$ 24
U.S. Treasury bill	39,698	28	-	39,726
Zero Coupon Bond	2,737	397	-	3,134
Other	1,061	11	-	1,072
	$ 43,520	$ 436	$ -	$ 43,956
2005				
National Rural Utilities Cooperative Finance Corporation Promissory Note	$ 24	$ -	$ -	$ 24
U.S. Treasury bill	37,374	-	(10)	37,364
Zero Coupon Bond	2,563	465	-	3,028
Other	1,935	230	-	2,165
	$ 41,896	$ 695	$ (10)	$ 42,581

Proceeds from maturities and calls of securities were $57,785,000 and $79,465,000 in 2006 and 2005, respectively. There were no realized gains or losses on those calls.

(Continued)

NOTE 4 - INVESTMENT SECURITIES (Continued)

Amortized cost and estimated fair value of investment securities held to maturity at December 31 are as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2006				
National Rural Utilities Cooperative Finance Corporation				
3-5% capital term certificates	$ 7,655	$ -	$ (459)	$ 7,196
6.5875% subordinated term certificate	455	87	-	542
0% subordinated term certificate	106	-	(26)	80
	$ 8,216	$ 87	$ (485)	$ 7,818
2005				
National Rural Utilities Cooperative Finance Corporation				
3-5% capital term certificates	$ 7,655	$ -	$ (1,624)	$ 6,031
6.5875% subordinated term certificate	470	113	-	583
0% subordinated term certificate	112	-	(28)	84
	$ 8,237	$ 113	$ (1,652)	$ 6,698

(Continued)

NOTE 4 - INVESTMENT SECURITIES (Continued)

Investment securities held to maturity with unrealized losses at December 31 not recognized in net margin (deficit) are as follows (in thousands):

	Unrealized Loss Less than 12 months		Unrealized Loss 12 Months or More	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
2006				
3-5% capital term certificates	$ -	$ -	$ 7,196	$ (459)
0% subordinated term certificate	-	-	80	(26)
	$ -	$ -	$ 7,276	$ (485)
2005				
3-5% capital term certificates	$ -	$ -	$ 6,031	$ (1,624)
0% subordinated term certificate	-	-	84	(28)
	$ -	$ -	$ 6,115	$ (1,652)

The maturity dates on the above securities range from 2019 to 2080 and have no available trading market. However, it is management's intent to hold these securities until maturity, at which time management expects to recover full value.

The amortized cost and fair value of securities at December 31, 2006, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(in thousands)	
Available for sale		
Due in one year or less	$ 40,063	$ 40,085
Due after one year through five years	2,396	2,799
Due after ten years	1,061	1,072
	$ 43,520	$ 43,956
Held to maturity		
Due after ten years	$ 8,216	$ 7,818
	$ 8,216	$ 7,818

(Continued)

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NOTE 5 - LONG-TERM DEBT

Long-term debt outstanding at December 31, 2006 and 2005 consisted of the following (in thousands):

	2006	2005
First mortgage notes:		
4.241% - 10.657%, payable quarterly to Federal Financing Bank (FFB) in varying amounts through 2038	$ 1,108,580	$ 1,107,491
2%, 5%, and 5.125% payable quarterly to RUS in varying amounts through 2024	49,507	54,643
3.8%, payable quarterly to CFC in varying amounts through 2014	20,440	21,769
Fixed rate loan, 7.7%, payable semiannually in varying amounts to National Cooperative Services Corporation through 2012	8,400	9,600
Promissory notes:		
6.20% - 6.45% variable rate note payable to CFC in 2010	405,000	80,000
Pollution control bonds:		
Series 1984B, variable rate bonds, due October 15, 2014, 4.03% at December 31, 2006 and 3.70% at December 31, 2005	82,100	88,600
Series 1984J, variable rate bonds, due October 15, 2014, 3.55% at December 31, 2006 and 2.95% at December 31, 2005	18,260	21,145
Solid waste disposal revenue bonds, Series 1993B, variable rate bonds, due August 15, 2023, interest rate 3.68% at December 31, 2006 and 2.85% at December 31, 2005	8,800	9,100
	1,701,087	1,392,348
Less current portion of long-term debt	57,782	53,085
	$ 1,643,305	$ 1,339,263

(Continued)

NOTE 5 - LONG-TERM DEBT (Continued)

In September 2002, RUS approved a loan application in the amount of $223,500,000 for the design, purchase, and installation of NOx reduction equipment and electrostatic precipitators, including plant modifications and related expenditures on Spurlock Power Station Units No. 1 and 2. Advances on these loans are subject to certain conditions outlined by RUS, and the non-governmental portions of such loans are subject to authorization from the KPSC. At December 31, 2006, $15,200,000 of these amounts remained to be advanced.

In September 2003, RUS approved a loan application in the amount of $433,863,000 for the construction of the Gilbert Unit at the Spurlock Power Station, including engineering services, preliminary structural design, and related transmission facilities. Advances on these loans are subject to certain conditions outlined by RUS and the non-governmental portions of such loans are subject to authorization from the KPSC. At December 31, 2006, $49,863,000 of these amounts remained to be advanced.

In September 2003, RUS approved a loan application in the amount of $27,645,000 for the construction of five landfill gas to energy generating units including engineering services, preliminary structural design, and related transmission facilities. Advances on these loans are subject to certain conditions outlined by RUS and the non-governmental portions of such loans are subject to authorization from the KPSC. As of December 31, 2006, $14,453,000 of these amounts remained to be advanced.

In May 2005, RUS approved a loan application in the amount of $55,240,000 for the construction of two additional combustion turbines at the J.K. Smith site, including engineering services, preliminary structural design, and related transmission facilities. Advances on these loans are subject to certain conditions outlined by RUS and the non-governmental portions of such loans are subject to authorization from the KPSC. As of December 31, 2006, $2,240,000 of these amounts remained to be advanced.

In August 2005, RUS approved a loan application in the amount of $64,240,000 for the construction of various transmission projects. Advances on these loans are subject to certain conditions outlined by RUS and the non-governmental portions of such loans are subject to authorization from the KPSC. At December 31, 2006, this loan has not been cleared by RUS for advance of loan funds.

In September 2005, the Cooperative entered into an unsecured credit facility syndicate with the co-arrangers of CFC and the Bank of Tokyo-Mitsubishi. This loan was approved for a total of $650,000,000 for general operating expenses and capital construction projects. As of December 31, 2006, $245,000,000 of this amount remained to be advanced.

(Continued)

NOTE 5 - LONG-TERM DEBT (Continued)

In March 2006, RUS approved a loan application in the amount of $481,388,000 for the construction of the Unit #4 at the Spurlock Power Station, including engineering services, preliminary structural design, and related transmission facilities. Advances on these loans are subject to certain conditions outlined by RUS and the non-governmental portions of such loans are subject to authorization from the KPSC. At December 31, 2006, this loan has not been cleared by RUS for advance of loan funds.

In accordance with the Rural Electrification Act of 1936 (RE Act), as amended, the RUS established a cushion of credit program. Under this program, RUS borrowers may make voluntary deposits into a special cushion of credit account. This cushion of credit account balance accrues interest at a rate of 5 percent per annum. The amounts in the cushion of credit account (deposits and earned interest) can only be used to make scheduled payments on loans made or guaranteed under the RE Act. As of December 31, 2006 and 2005, the Cooperative's cushion of credit account balance was $75,875,000 and $26,375,000.

The interest rate on the Series 1984B Pollution Control Bonds is subject to change weekly and the interest rate on the Series 1984J Pollution Control Bonds and the Series 1993B Solid Waste Disposal Revenue Bonds are subject to change semiannually. The interest rate adjustment period on any series of the above-mentioned variable rate bonds may be converted to a weekly, semiannual, annual or three-year basis or to a fixed-rate basis, at the option of the Cooperative.

Long-term pollution control and solid waste disposal revenue bonds require that debt service reserve funds be on deposit with a trustee throughout the term of the bonds. Debt service reserve requirements are as follows: Series 1984B - $12,717,000; Series 1984J - $5,368,500; and Series 1993B - $1,062,000. In addition, mandatory sinking fund payments are required for each series as follows: Series 1984B – payments range from $7,500,000 in 2007 to $13,150,000 in 2013; Series 1984J – payments range from $3,190,000 in 2007 to $4,325,000 in 2010; and Series 1993B – payments range from $300,000 in 2007 to $700,000 in 2023. Debt service reserve and construction funds are held by trustees and are invested primarily in U.S. Government securities and CFC promissory notes. These funds are included in investment securities available for sale and have a fair value of approximately $20,567,000 at December 31, 2006.

Estimated maturities of long-term debt for the five years subsequent to December 31, 2006 are as follows: 2007 - $57,782,000; 2008 - $60,438,000; 2009 - $63,618,000; 2010 - $471,990,000; 2011 - $70,241,000; and thereafter - $977,018,000.

(Continued)

NOTE 5 - LONG-TERM DEBT (Continued)

Under the terms of the loan agreements with RUS, CFC and institutional investors, the Cooperative is required to maintain certain levels of members' equities, interest coverage, and debt service coverage. Because of the 2006 Environmental Protection Agency ("EPA") Notice of Violation discussed in detail in Note 7, the Cooperative was in technical default of the members' equities covenant related to the $80,000,000 in outstanding debt under the Credit Facility in 2005. Under the terms of the Credit Facility loan agreement, the required lenders had the right to immediately demand payment of the entire principal and interest balances owed them, or to terminate the loan commitment. On April 6, 2006, the required lenders waived their rights related to this technical default. On April 6, 2006, the covenants in the Credit Facility loan agreement were modified and the Cooperative was in compliance with the amended agreement.

Effects of this Notice of Violation have caused the Cooperative not to meet certain loan covenants as of December 31, 2006. Although the Cooperative is not in default of any of its loan agreements, the lenders have required the Cooperative to file a plan of corrective action. The Cooperative has developed a plan of corrective action and presented it to the lenders.

Substantially all assets are pledged as collateral for first mortgage notes payable to the United States of America (RUS and FFB) and CFC.

NOTE 6 - RETIREMENT BENEFITS

Pension Plan: Pension benefits for substantially all employees are provided through participation in the National Rural Electric Cooperative Association's Retirement and Security Program, a multi-employer defined benefit plan. The Cooperative's required contributions were approximately $7,883,000 and $7,094,000 for 2006 and 2005, respectively. The Cooperative expects to contribute approximately $8,500,000 to the plan in 2007.

Retirement Savings Plan: The Cooperative has a Retirement Savings Plan for all employees who are eligible to participate in the Cooperative's benefit programs. The plan allows participants to make contributions by salary reduction, pursuant to Section 401(k) of the Internal Revenue Code. The Cooperative makes matching contributions to the account of each participant up to 2 percent of the participant's compensation. The Cooperative contributed approximately $775,000 and $743,000 to the plan in 2006 and 2005, respectively. Employees vest immediately in their contributions and the contributions of the Cooperative. The Cooperative expects to contribute approximately $743,000 to the plan in 2007.

(Continued)

NOTE 6 - RETIREMENT BENEFITS (Continued)

Supplemental Death Benefit Plan: The Cooperative provides a Supplemental Death Benefit Plan to all employees eligible to participate in the pension plan. The supplemental death benefit is payable to a deceased employee's beneficiary if the lump sum value of a 100% survivor benefit under the pension plan exceeds the pension plan benefits plus the Cooperative's group life insurance proceeds. Management believes that any liability related to this plan will not have a material effect on the consolidated financial statements.

Postretirement Medical Benefits: The Cooperative sponsors a defined benefit plan that provides medical and life insurance coverage to retirees and their dependents. Participating retirees and dependents contribute 50 percent of the projected cost of coverage. For purposes of the liability estimates, the substantive plan is assumed to be the same as the extant written plan. The plan is not funded.

The following table sets forth the plan's status reconciled with the amount shown in the Cooperative's balance sheets at December 31, 2006 and 2005 (dollars in thousands):

	2006	2005
Change in plan assets:		
Fair value of plan assets at beginning of year	$	$ -
Employer contribution	487	611
Plan participants' contribution	487	610
Benefits paid	(974)	(1,221)
Fair value of plan assets at end of year	-	-
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 35,151	$ 34,258
Service cost-benefits attributed to service during the period	1,219	1,166
Interest cost on accumulated postretirement benefit obligation	2,095	1,931
Benefits paid	(974)	(1,221)
Plan participants' contribution	487	610
Actuarial gain	249	(1,593)
Benefit obligation at end of year	38,227	35,151

(Continued)

NOTE 6 - RETIREMENT BENEFITS (Continued)

	2006	2005
Funded status	$ (38,227)	$ (35,151)
Unrecognized actuarial gain	(10,436)	(11,453)
Accrued benefit cost	$ (48,663)	$ (46,604)

Components of net periodic postretirement benefit cost (dollars in thousands):

	2006	2005
Service cost-benefits attributed to service during the period	$ 1,219	$ 1,166
Interest cost on accumulated postretirement benefit obligation	2,095	1,931
Amortization of unrecognized actuarial gain	(767)	(514)
Net periodic benefit cost	$ 2,547	$ 2,583

The discount rate used in determining the accumulated postretirement benefit obligation for 2006 and 2005 was 6.00%.

The Cooperative expects to contribute approximately $805,000 to the plan in 2007.

The following expected benefit payments from the plan, which reflect anticipated future service, are (dollars in thousands):

2007	$ 805
2008	934
2009	1,046
2010	1,173
2011	1,312
2012 - 2016	9,147
Total	$ 14,417

For measurement purposes, a 10 percent annual rate of increase in the per capita cost of covered health care benefits was used for the year ended December 31, 2006. The rate is assumed to decline to 5 percent after five years.

(Continued)

NOTE 6 - RETIREMENT BENEFITS (Continued)

The health care cost trend rate assumption has a significant effect on the amounts reported.

	2006	2005
Effect on total of service cost and interest cost components (dollars in thousands)		
1-percentage-point increase	$ 697	$ 705
1-percentage-point decrease	(540)	(514)
Effect on postretirement benefit obligation (dollars in thousands)		
1-percentage-point increase	$ 6,776	$ 6,986
1-percentage-point decrease	(5,381)	(5,476)

In September 2006, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 158 (SFAS 158). SFAS 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability on its balance sheet and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. The Cooperative is required to adopt SFAS 158 in 2007. Had the Cooperative adopted SFAS 158 in 2006, comprehensive income would have increased by approximately $10,436,000.

NOTE 7 - COMMITMENTS, EXPENDITURES AND CONTINGENCIES

The Cooperative has entered into long-term power purchase agreements having minimum payment obligations for the five years subsequent to December 31, 2006 as follows (dollars in thousands):

2007	$ 4,553
2008	5,314
2009	7,595
2010	7,595
2011	7,595

(Continued)

NOTE 7 - COMMITMENTS, EXPENDITURES AND CONTINGENCIES (Continued)

The Cooperative is committed to purchase coal for its generating plants under long-term contracts having minimum purchase obligations as follows (dollars in thousands):

2007	$ 163,741
2008	99,612
2009	85,845
2010	56,334
2011	45,159

The minimum cost of the coal purchases, based on the latest contractual prices, is subject to escalation clauses that are generally based on government-published indices and market price re-openers.

There are pending civil claims in litigation against the Cooperative. Under the Cooperative's general liability insurance program, it is responsible for a deductible amount up to $1,000,000 for each occurrence. Neither the probable outcome nor ultimate liability resulting from any claims and litigation can be readily determined at this time. Accruals have been made when appropriate and management believes that any liability for such matters will, in any case, not have a material effect on the consolidated financial statements.

On January 28, 2004, the federal Environmental Protection Agency (EPA) sued the Cooperative alleging that physical or operating changes to three coal-fired generators resulted in simultaneous violations of the Prevention of Significant Deterioration provision of the Clean Air Act; the New Source Performance Standards of the Clean Air Act; and the State Implementation Plan for Kentucky, as approved by EPA. The lawsuit seeks injunctive relief, and civil penalties of up to $25,000 a day before January 31, 1997, and $27,500 a day since then.

As a result of this lawsuit, the Cooperative has done the following:

On January 17, 2006, EKPC filed four motions with the court asking that most, if not all of the claims, be dismissed. These motions for summary judgment involved,

(a) statute of limitation issues;
(b) federal enforceability of the Spurlock No. 2 operating permit;
(c) applicability of the routine maintenance exclusion; and
(d) calculation of emissions under PSD based on post-change actual annual emission where the baseline emission calculations are based on actual historic annual emissions prior to project work, and not based on hypothetical emissions.

(Continued)

NOTE 7 - COMMITMENTS, EXPENDITURES AND CONTINGENCIES (Continued)

On September 26, 2006, the court issued an order dismissing most of the government's motions without prejudice pending a final decision in a similar case. A decision in this similar case is expected in summer 2007.

The Cooperative believes that when all the evidence is presented, the facts will bear out that the Cooperative complied with the requirements, and acted in good faith.

On January 17, 2006, the Cooperative received a Notice of Violation (NOV) from the EPA alleging violations of the Federal Clean Air Act's Acid Rain Program and NOx SIP Call Allowance Trading Program at Dale Units 1 and 2. At issue is EPA's allegation that the Cooperative incorrectly reported the turbine, rather than the generator, nameplate ratings, thus placing the Units under the Acid Rain Program. On February 10, 2006, the Cooperative received an NOV from the Kentucky Environmental and Public Protection Cabinet regarding the same matter. The NOV's cover the years 2000 through 2004.

Under a strict application of the Acid Rain Program, owners and operators of a unit that is determined to have excess emissions of SO2 are subject to non-discretionary penalties, must surrender SO2 allowances to cover previous emissions, and also may be subject to discretionary penalties. There may also be penalties relating to NOx emissions requirements.

Because the Cooperative did not have emissions monitoring equipment in place on Dale Units 1 and 2, on March 1, 2006, the Cooperative petitioned EPA to allow the calculation of the emissions on coal burn fuel data versus missing data procedures. Depending on the resolution of this petition, an additional $68,000,000 in non-discretionary penalties could be assessed. At this time, it is not possible to predict the likelihood of success or whether these non-discretionary penalties could be waived or reduced by the agency or a court. The Cooperative is also required to surrender SO2 allowances to cover the emissions for 2000 through 2004. Additional expense to cover such emissions, assuming current market prices, could be $25,000,000. Civil penalties similar to those outlined above from the EPA lawsuit may also apply.

The Cooperative has certain generating plants that contain asbestos, which is required by law to be removed or contained if the plants are renovated or demolished. The Cooperative has no plans to retire any of its generating plants. Because there is an indeterminate settlement date for the asset retirement obligation, the range of time over which the Cooperative may settle the obligation is unknown. Therefore, a fair value determination of an asset retirement obligation cannot be reasonably estimated.

(Continued)

NOTE 7 - COMMITMENTS, EXPENDITURES AND CONTINGENCIES (Continued)

In September 2004, the Board approved the construction of a 278-megawatt circulating fluidized bed baseload unit at Spurlock Station. The cost of construction of the generating unit, including related interconnection facilities, will approximate $522 million.

In November 2004, the Board approved the construction of a 278-megawatt circulating fluidized bed baseload unit at the J.K. Smith Station. The cost of construction of the generating unit, including related interconnection facilities, will approximate $625 million.

In December 2004, the Board approved the construction of five gas-fired combustion turbines to be located at the Cooperative's J.K. Smith Power Station. Construction of three of the combustion turbines has been deferred until after 2009. The first two combustion turbines are expected to cost approximately $66 million and are scheduled to become operational in 2009.

In September 2005, the Board approved construction of a new limestone scrubber for Spurlock Unit 2, with a wet precipitator, at a cost of approximately $159 million.

In January 2006, the Board approved the construction of a new limestone scrubber for Spurlock Unit 1, with a wet precipitator, at a cost of approximately $145 million.

The construction projects mentioned above are subject to KPSC approval.

NOTE 8 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and Cash Equivalents: The carrying amount approximates fair value because of the short maturity of these instruments.

Accounts Receivable and Accounts Payable: The fair values of accounts receivable and payable are based on carrying value due to the short-term nature of the instruments.

Investment Securities: The fair values of investment securities are estimated based on quoted market prices for the same or similar investments.

Long-Term Accounts Receivable: The fair values of long-term accounts receivable are estimated based on quoted interest rates for similar maturities.

(Continued)

NOTE 8 - FAIR VALUE OF FINANCIAL INSTRUMENTS (Continued)

Notes Payable: The carrying amount approximates fair value because of the variable rate and payable on demand terms of the financial instrument.

Long-Term Debt: The fair value of the Cooperative's long-term debt that is practicable to estimate, is estimated based on the quoted market prices for the same or similar issues or on the current rates available to the Cooperative for debt of the same remaining maturities, including the appropriate redemption premium, if any.

The estimated fair values of the Cooperative's financial instruments are as follows (in thousands):

	2006		2005	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets				
Cash and cash equivalents	$ 69,202	$ 69,202	$ 43,863	$ 43,863
Accounts receivable	62,091	62,091	77,663	77,663
Investment securities				
Available for sale	43,956	43,956	42,581	42,581
Held to maturity	8,216	7,818	8,237	6,698
Long-term accounts receivable	8,572	9,266	9,002	10,067
Financial liabilities				
Long-term debt	$1,701,087	$1,713,203	$1,392,348	$1,418,017
Accounts payable	90,977	90,977	75,855	75,855