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PUBLIC SERVICE  
COMMISSION

Mr. Jeff DeRouen  
Executive Director  
Kentucky Public Service Commission  
211 Sower Boulevard  
Frankfort, KY 40601

**Kentucky Utilities Company**  
State Regulation and Rates  
220 West Main Street  
PO Box 32010  
Louisville, Kentucky 40232  
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Director - Rates  
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March 31, 2010

**RE: APPLICATION OF KENTUCKY UTILITIES COMPANY FOR AN  
ADJUSTMENT OF ITS BASE RATES - Case No. 2009-00548**  
*(Updates to Question Nos. 43, 44, and 55; AG-1 Question No. 188)*

Dear Mr. DeRouen:

On February 16, 2010, in the above-referenced proceeding, Kentucky Utilities Company ("KU") filed initial responses to Question Nos. 43, 44, and 55 of the First Data Request of Commission Staff dated January 19, 2010. Pursuant to the directives in each of these data requests, KU hereby provides an original and ten (10) copies of the following information:

- PSC-1 Question No. 43 - updated Rives Exhibit 2 and Analysis of Embedded Cost of Capital to reflect changes through February 28, 2010.
- PSC-1 Question No. 44 - detailed monthly income statements for February 2010.
- PSC-1 Question No. 55 - updated actual rate case expenses through February 28, 2010.

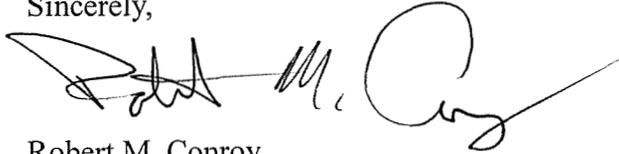
In response to Question No. 188 of the Attorney General's Initial Requests for Information dated March 1, 2010, KU stated it would provide 2009 financial statements once available. KU hereby provides an original and ten (10) copies of the Updated Response to Question No. 188 with the KU and E.ON U.S. LLC 2009 financial statements.

Mr. Jeff DeRouen  
March 31, 2010

Please confirm your receipt of these documents by placing the File Stamp of your Office on the enclosed additional copy.

Please contact me if you have any questions about this filing.

Sincerely,

A handwritten signature in black ink, appearing to read "Robert M. Conroy". The signature is fluid and cursive, with a large, prominent "C" at the end.

Robert M. Conroy

Enclosures

cc: Parties of Record

VERIFICATION

COMMONWEALTH OF KENTUCKY )  
 ) SS:  
COUNTY OF JEFFERSON )

The undersigned, **S. Bradford Rives**, being duly sworn, deposes and says that he is Chief Financial Officer for Kentucky Utilities Company and an employee of E.ON U.S. Services, Inc., and that he has personal knowledge of the matters set forth in the responses for which he is identified as the witness, and the answers contained therein are true and correct to the best of his information, knowledge and belief.

  
\_\_\_\_\_  
**S. Bradford Rives**

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 31<sup>st</sup> day of March 2010.

 (SEAL)  
\_\_\_\_\_  
Notary Public

My Commission Expires:

Sept 20, 2010



VERIFICATION

COMMONWEALTH OF KENTUCKY )  
 ) SS:  
COUNTY OF JEFFERSON )

The undersigned, **Shannon L. Charnas**, being duly sworn, deposes and says that she is Director – Utility Accounting and Reporting for E.ON U.S. Services, Inc., and that she has personal knowledge of the matters set forth in the responses for which she is identified as the witness, and the answers contained therein are true and correct to the best of her information, knowledge and belief.

*Shannon L. Charnas*  
**Shannon L. Charnas**

Subscribed and sworn to before me, a Notary Public in and before said County and State, this 31st day of March 2010.

*Victoria B. Harper* (SEAL)  
Notary Public

My Commission Expires:

*Sept 20, 2010*

**KENTUCKY UTILITIES COMPANY**

**CASE NO. 2009-00548**

**UPDATED Response to First Data Request of Commission Staff  
Dated January 19, 2010**

**Updated Response filed March 31, 2010**

**Question No. 43**

**Responding Witness: S. Bradford Rives**

- Q-43. Provide any information, when known, that would have a material effect on net operating income, rate base, or cost of capital that has occurred after the test year but were not incorporated in the filed testimony and exhibits.
- A-43. See attached Updated Rives Exhibit 2 and Analysis of the Embedded Cost of Capital, reflecting changes to embedded cost of capital through February 28, 2010.

KENTUCKY UTILITIES

Capitalization at October 31, 2009  
with Annual Cost Rate as of February 28, 2010

	Per Books 10-31-09 (1)	Capital Structure (2)	Trimble County Joint Use Assets Transfer (3)	Undistributed Subsidiary Earnings (4)	Investment in EEI (Col 2 x Col 5 Line 4) (5)	Investments in OVEC and Other (Col 2 x Col 6 Line 4) (6)	Adjustments to Total Co. Capitalization (Sum of Col 3 - Col 6) (7)	Adjusted Total Company Capitalization (Col 1 - Col 7) (8)	Jurisdictional Rate Base Percentage (Exhibit 3 Line 19) (9)	Kentucky Jurisdictional Capitalization (Col 8 x Col 9) (10)
1. Short Term Debt	\$ 19,665,954	0.55%	\$ 266,095	\$ -	\$ (7,127)	\$ (4,621)	\$ 254,347	\$ 19,920,301	87.15%	\$ 17,360,542
2. Long Term Debt	1,631,779,405	45.52%	22,022,972	-	(589,848)	(382,487)	21,050,637	1,652,830,042	87.15%	1,440,441,382
3. Common Equity	1,933,128,508	53.93%	26,091,802	(6,207,858)	(698,825)	(453,153)	18,731,966	1,951,860,473	87.15%	1,701,046,402
4. Total Capitalization	<u>\$ 3,584,573,867</u>	<u>100.00%</u>	<u>\$ 48,380,869</u>	<u>\$ (6,207,858)</u>	<u>\$ (1,295,800)</u>	<u>\$ (840,261)</u>	<u>\$ 40,036,950</u>	<u>\$ 3,624,610,816</u>		<u>\$ 3,158,848,326</u>

	Adjusted Kentucky Jurisdictional Capitalization (Col 10 - Col 12) (13)	Environmental Compliance Plans (6) (Col 11 x Col 12 Line 4) (12)	Adjusted Capital Structure (14)	Annual Cost Rate February 28, 2010 (15)	Cost of Capital (Col 15 x Col 14) (16)
1. Short Term Debt	\$ 16,786,866	\$ (573,676)	0.55%	0.20%	0.00%
2. Long Term Debt	1,392,878,436	(47,562,946)	45.60%	4.66%	2.12%
3. Common Equity	1,644,878,318	(56,168,084)	53.85%	11.50%	6.19%
4. Total Capitalization	<u>\$ 3,054,543,620</u>	<u>\$ (104,304,706)</u>	<u>100.00%</u>		<u>8.31%</u>

(a) Environmental Compliance Plans:

Total Jurisdictional ECR Rate Base at 10/31/09	\$ 1,120,801,977
Less: Jurs ECR Rate Base '01 and '03 Plans	149,293,659
Less: Jurs ECR Rate Base Roll-In '05 and '06 Plans	867,203,612
Jurisdictional ECR Post '03 Rate Base	<u>\$ 104,304,706</u>

NOTES:  
Column 15 used February 28, 2010 actual embedded cost rates.

**KENTUCKY UTILITIES COMPANY**  
**ANALYSIS OF THE EMBEDDED COST OF CAPITAL AT**  
**February 28, 2010**

<b>LONG-TERM DEBT</b>										
	Due	Rate	Principal	Interest	Annualized Cost			Letter of Credit and other fees	Total	Embedded Cost
					Amortized Debt Issuance Expense	Amortized Loss- Reacquired Debt				
<b>Pollution Control Bonds</b>										
Mercer Co 2000 Series A	05/01/23	0.16000% *	12,900,000	20,640	-	46,743	94,413	a	161,796	1.254%
Carroll Co 2002 Series A	02/01/32	0.95000% *	20,930,000	198,835	4,104	36,300	20,930	b	260,169	1.243%
Carroll Co 2002 Series B	02/01/32	0.95000% *	2,400,000	22,800	2,856	4,164	2,400	b	32,220	1.343%
Muhlenberg Co 2002 Series A	02/01/32	0.95000% *	2,400,000	22,800	1,140	12,744	2,400	b	39,084	1.629%
Mercer Co 2002 Series A	02/01/32	0.95000% *	7,400,000	70,300	3,180	12,900	7,400	b	93,780	1.267%
Carroll Co 2002 Series C	10/01/32	0.21200% *	96,000,000	203,520	73,658	186,036	240,000	c	703,214	0.733%
Carroll Co 2004 Series A	10/01/34	0.23000% *	50,000,000	115,000	-	105,023	409,041	d	629,064	1.258%
Carroll Co 2006 Series B	10/01/34	0.29000% *	54,000,000	156,600	47,757	-	441,990	d	646,347	1.197%
Carroll Co 2007 Series A	02/01/26	5.75000% *	17,875,000	1,027,813	33,166	-	-		1,060,979	5.936%
Trimble Co 2007 Series A	03/01/37	6.00000% *	8,927,000	535,620	16,022	-	-		551,642	6.179%
Carroll Co 2008 Series A	02/01/32	0.29000% *	77,947,405	226,047	34,268	-	636,669	d	896,984	1.151%
Called Bonds			-	-	-	200,687	1		200,687	0.000%
<b>Total External Debt</b>			<b>350,779,405</b>	<b>2,599,975</b>	<b>216,151</b>	<b>604,597</b>	<b>1,855,243</b>		<b>5,275,966</b>	<b>0.314%</b>
<b>Notes Payable to Fidelity Corp</b>										
Notes Payable to Fidelity Corp	11/24/10	4.240%	33,000,000	1,399,200	-	-	-		1,399,200	4.240%
Notes Payable to Fidelity Corp	01/16/12	4.390%	50,000,000	2,195,000	-	-	-		2,195,000	4.390%
Notes Payable to Fidelity Corp	04/30/13	4.550%	100,000,000	4,550,000	-	-	-		4,550,000	4.550%
Notes Payable to Fidelity Corp	08/15/13	5.310%	75,000,000	3,982,500	-	-	-		3,982,500	5.310%
Notes Payable to Fidelity Corp	12/19/14	5.450%	100,000,000	5,450,000	-	-	-		5,450,000	5.450%
Notes Payable to Fidelity Corp	07/08/15	4.735%	50,000,000	2,367,500	-	-	-		2,367,500	4.735%
Notes Payable to Fidelity Corp	12/21/15	5.360%	75,000,000	4,020,000	-	-	-		4,020,000	5.360%
Notes Payable to Fidelity Corp	10/25/16	5.675%	50,000,000	2,837,500	-	-	-		2,837,500	5.675%
Notes Payable to Fidelity Corp	06/20/17	5.980%	50,000,000	2,990,000	-	-	-		2,990,000	5.980%
Notes Payable to Fidelity Corp	07/25/18	6.160%	50,000,000	3,080,000	-	-	-		3,080,000	6.160%
Notes Payable to Fidelity Corp	08/27/18	5.645%	50,000,000	2,822,500	-	-	-		2,822,500	5.645%
Notes Payable to Fidelity Corp	12/17/18	7.035%	75,000,000	5,276,250	-	-	-		5,276,250	7.035%
Notes Payable to Fidelity Corp	10/25/19	5.710%	70,000,000	3,997,000	-	-	-		3,997,000	5.710%
Notes Payable to Fidelity Corp	02/07/22	5.690%	53,000,000	3,015,700	-	-	-		3,015,700	5.690%
Notes Payable to Fidelity Corp	05/22/23	5.850%	75,000,000	4,387,500	-	-	-		4,387,500	5.850%
Notes Payable to Fidelity Corp	09/14/28	5.960%	100,000,000	5,960,000	-	-	-		5,960,000	5.960%
Notes Payable to Fidelity Corp	06/23/36	6.330%	50,000,000	3,165,000	-	-	-		3,165,000	6.330%
Notes Payable to Fidelity Corp	03/30/37	5.860%	75,000,000	4,395,000	-	-	-		4,395,000	5.860%
Notes Payable to Fidelity Corp	04/24/17	5.280%	50,000,000	2,640,000	-	-	-		2,640,000	5.280%
Notes Payable to Fidelity Corp	07/29/19	4.810%	50,000,000	2,405,000	-	-	-		2,405,000	4.810%
Notes Payable to Fidelity Corp	11/25/19	4.445%	50,000,000	2,222,500	-	-	-		2,222,500	4.445%
<b>Total Internal Debt</b>			<b>1,331,000,000</b>	<b>73,158,150</b>	<b>-</b>	<b>-</b>	<b>-</b>		<b>73,158,150</b>	<b>4.350%</b>
<b>Total</b>			<b>1,681,779,405</b>	<b>75,758,125</b>	<b>216,151</b>	<b>604,597</b>	<b>1,855,243</b>		<b>78,434,116</b>	<b>4.664%</b>

<b>SHORT TERM DEBT</b>									
	Rate	Principal	Interest	Annualized Cost			Total	Embedded Cost	
				Expense	Loss	Premium			
Notes Payable to Associated Company	0.200% *	77,898,954	155,798	-	-	-	155,798	0.200%	
<b>Total</b>		<b>77,898,954</b>	<b>155,798</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>155,798</b>	<b>0.200%</b>	
<b>Embedded Cost of Total Debt</b>		<b>1,759,678,359</b>	<b>75,913,923</b>	<b>216,151</b>	<b>604,597</b>	<b>1,855,243</b>	<b>78,589,914</b>	<b>4.466%</b>	

\* Composite rate at end of current month

1 Series P and R bonds were redeemed in 2003, and 2005, respectively. They were not replaced with other bond series. The remaining unamortized expense is being amortized over the remainder of the original lives (due 5/15/07, 6/1/25, 6/1/35, and 6/1/36 respectively) of the bonds as loss on required debt.

a - Letter of credit fee = (principal bal + 45 days interest)\* 70% Rate based on company credit rating Additional fee of \$250/month for drawdown

b - Remarketing fee = 10 basis points

c - Remarketing fee = 25 basis points

d - Is a and b combined.

**KENTUCKY UTILITIES COMPANY**

**CASE NO. 2009-00548**

**UPDATED Response to First Data Request of Commission Staff  
Dated January 19, 2010**

**Updated Response filed March 31, 2010**

**Question No. 44**

**Responding Witness: Shannon L. Charnas**

- Q-44. Provide detailed monthly income statements for each month after the test year, including the month in which the hearing ends, as they become available.
- A-44. See attached income statements for February 2010.

**KENTUCKY UTILITIES COMPANY**

Income Statements

February 28, 2010

Kentucky Utilities Company  
Comparative Statement of Income  
February 28, 2010

	Current Month		
	This Year Amount	Last Year Amount	Increase or Decrease Amount %
Electric Operating Revenues.....	159,443,944.63	119,980,660.74	39,463,283.89 (263,000.00)
Rate Refunds.....	(263,000.00)	-	(100.00)
Total Operating Revenues.....	159,180,944.63	119,980,660.74	39,200,283.89
Fuel for Electric Generation.....	42,309,414.21	37,270,222.07	5,039,192.14
Power Purchased.....	17,140,187.20	21,373,628.80	(4,233,441.60)
Other Operation Expenses.....	16,641,809.35	28,836,974.73	(12,195,165.38)
Maintenance.....	6,149,235.86	40,059,251.04	(33,910,015.18)
Depreciation.....	10,773,749.14	9,888,397.00	885,352.14
Amortization Expense.....	590,936.94	377,441.78	213,495.16
Regulatory Credits.....	(206,097.51)	(196,501.63)	(9,595.88)
Taxes			
Federal Income.....	19,186,881.82	(8,066,155.63)	27,253,037.45
State Income.....	3,447,392.08	(1,471,031.42)	4,918,423.50
Deferred Federal Income - Net.....	(283,681.90)	-	(283,681.90)
Deferred State Income - Net.....	-	-	-
Property and Other.....	1,623,896.13	1,839,723.38	(215,827.25)
Investment Tax Credit.....	-	-	-
Loss (Gain) from Disposition of Allowances.....	-	-	-
Accretion Expense.....	181,352.55	171,752.67	9,599.88
Total Operating Expenses.....	117,555,075.87	130,083,702.79	(12,528,626.92)
Net Operating Income.....	41,625,868.76	(10,103,042.05)	51,728,910.81
Other Income Less Deductions			
Other Income Less Deductions.....	863,212.67	288,489.11	574,723.56
AFUDC - Equity.....	(12,137.20)	597,927.01	(610,064.21)
Total Other Income Less Deductions.....	851,075.47	886,416.12	(35,340.65)
Income Before Interest Charges.....	42,476,944.23	(9,216,625.93)	51,693,570.16
Interest on Long-Term Debt.....	6,304,013.57	5,816,775.69	487,237.88
Amortization of Debt Expense - Net.....	68,395.59	66,709.61	1,685.98
Other Interest Expenses.....	226,907.58	130,144.99	96,762.59
AFUDC - Borrowed Funds.....	(79,557.68)	(179,067.78)	99,510.10
Total Interest Charges.....	6,519,759.06	5,834,562.51	685,196.55
Net Income.....	35,957,185.17	(15,051,188.44)	51,008,373.61

**Kentucky Utilities Company**  
**Comparative Statement of Income**  
**February 28, 2010**

	Year to Date		
	This Year Amount	Last Year Amount	Increase or Decrease Amount %
Electric Operating Revenues.....	296,159,329.28	252,509,634.30	43,649,694.98 17.29
Rate Refunds.....	(721,769.21)	-	(721,769.21) (100.00)
Total Operating Revenues.....	<u>295,437,560.07</u>	<u>252,509,634.30</u>	<u>42,927,925.77</u> 17.00
Fuel for Electric Generation.....	92,790,041.50	82,636,332.44	10,153,709.06 12.29
Power Purchased.....	36,406,827.70	44,444,383.85	(8,037,556.15) (18.08)
Other Operation Expenses.....	33,187,089.31	43,427,305.86	(10,240,216.55) (23.58)
Maintenance.....	14,110,863.46	50,471,027.45	(36,360,163.99) (72.04)
Depreciation.....	21,535,183.62	21,829,926.13	(294,742.51) (1.35)
Amortization Expense.....	1,163,071.88	841,880.35	321,191.53 38.15
Regulatory Credits.....	(411,429.52)	(392,105.12)	(19,324.40) (4.93)
Taxes			
Federal Income.....	26,450,036.26	(1,851,508.85)	28,301,545.11 1,528.57
State Income.....	4,771,979.52	(275,907.04)	5,047,886.56 1,829.56
Deferred Federal Income - Net.....	(283,681.90)	-	(283,681.90) (100.00)
Deferred State Income - Net.....	-	-	-
Property and Other.....	3,416,268.81	3,677,326.94	(261,058.13) (7.10)
Investment Tax Credit.....	-	-	-
Loss (Gain) from Disposition of Allowances.....	-	-	-
Accretion Expense.....	361,825.90	342,607.27	19,218.63 5.61
Total Operating Expenses.....	<u>233,498,076.54</u>	<u>245,151,269.28</u>	<u>(11,653,192.74)</u> (4.75)
Net Operating Income.....	61,939,483.53	7,358,365.02	54,581,118.51 741.76
Other Income Less Deductions			
Other Income Less Deductions.....	1,381,128.59	3,011,057.46	(1,629,928.87) (54.13)
AFUDC - Equity.....	(24,270.34)	1,174,767.24	(1,199,037.58) (102.07)
Total Other Income Less Deductions.....	<u>1,356,858.25</u>	<u>4,185,824.70</u>	<u>(2,828,966.45)</u> (67.58)
Income Before Interest Charges.....	63,296,341.78	11,544,189.72	51,752,152.06 448.30
Interest on Long-Term Debt.....	12,616,293.65	11,641,390.53	974,903.12 8.37
Amortization of Debt Expense - Net.....	136,790.79	133,104.38	3,686.41 2.77
Other Interest Expenses.....	749,520.59	302,779.09	446,741.50 147.55
AFUDC - Borrowed Funds.....	(158,113.57)	(351,820.47)	193,706.90 55.06
Total Interest Charges.....	<u>13,344,491.46</u>	<u>11,725,453.53</u>	<u>1,619,037.93</u> 13.81
Net Income.....	<u>49,951,850.32</u>	<u>(81,263.81)</u>	<u>50,133,114.13</u> 27,657.54

**Kentucky Utilities Company**  
**Comparative Statement of Income**  
**February 28, 2010**

	Year Ended Current Month		
	This Year Amount	Last Year Amount	Increase or Decrease Amount %
Electric Operating Revenues.....	1,400,307,928.85	1,415,289,759.97	(14,981,831.12) (1.06)
Rate Refunds.....	(1,191,000.00)	-	(1,191,000.00) (100.00)
<b>Total Operating Revenues.....</b>	<b>1,399,116,928.85</b>	<b>1,415,289,759.97</b>	<b>(16,172,831.12) (1.14)</b>
Fuel for Electric Generation.....	443,851,023.01	510,372,074.32	(66,521,051.31) (13.03)
Power Purchased.....	190,775,842.58	228,425,738.64	(37,649,896.06) (16.48)
Other Operation Expenses.....	186,060,425.28	184,055,327.69	2,005,097.59 1.09
Maintenance.....	66,913,943.57	125,790,646.60	(58,876,703.03) (46.81)
Depreciation.....	127,258,995.76	132,640,607.17	(5,381,611.41) (4.06)
Amortization Expense.....	6,388,059.66	5,309,558.40	1,078,501.26 20.31
Regulatory Credits.....	(2,425,264.04)	(2,289,182.11)	(136,081.93) (5.94)
Taxes			
Federal Income.....	23,535,189.88	27,042,180.92	(3,506,991.04) (12.97)
State Income.....	6,679,393.70	7,029,569.37	(350,175.67) (4.98)
Deferred Federal Income - Net.....	45,088,328.00	(10,193,508.02)	55,281,836.02 542.32
Deferred State Income - Net.....	7,902,649.63	(3,158,868.86)	11,061,518.49 350.17
Property and Other.....	20,695,554.69	20,901,589.72	(206,035.03) (0.99)
Investment Tax Credit.....	21,416,455.03	25,266,897.97	(3,850,442.94) (15.24)
Loss (Gain) from Disposition of Allowances.....	(84,707.76)	(583,106.55)	498,398.79 85.47
Accretion Expense.....	2,125,413.32	1,993,866.75	131,546.57 6.60
<b>Total Operating Expenses.....</b>	<b>1,146,181,302.31</b>	<b>1,252,603,392.01</b>	<b>(106,422,089.70) (8.50)</b>
<b>Net Operating Income.....</b>	<b>252,935,626.54</b>	<b>162,686,367.96</b>	<b>90,249,258.58 55.47</b>
Other Income Less Deductions			
Other Income Less Deductions.....	4,503,203.12	28,415,384.61	(23,912,181.49) (84.15)
AFUDC - Equity.....	2,706,859.43	6,341,864.73	(3,635,005.30) (57.32)
<b>Total Other Income Less Deductions.....</b>	<b>7,210,062.55</b>	<b>34,757,249.34</b>	<b>(27,547,186.79) (79.26)</b>
<b>Income Before Interest Charges.....</b>	<b>260,145,689.09</b>	<b>197,443,617.30</b>	<b>62,702,071.79 31.76</b>
Interest on Long-Term Debt.....	73,274,877.99	69,109,146.41	4,165,731.58 6.03
Amortization of Debt Expense - Net.....	818,824.75	755,800.66	63,024.09 8.34
Other Interest Expenses.....	3,775,726.83	4,552,166.24	(776,439.41) (17.06)
AFUDC - Borrowed Funds.....	(1,183,809.74)	(2,099,507.85)	915,698.11 43.61
<b>Total Interest Charges.....</b>	<b>76,685,619.83</b>	<b>72,317,605.46</b>	<b>4,368,014.37 6.04</b>
<b>Net Income.....</b>	<b>183,460,069.26</b>	<b>125,126,011.84</b>	<b>58,334,057.42 46.62</b>

**KENTUCKY UTILITIES COMPANY**

**CASE NO. 2009-00548**

**UPDATED Response to First Data Request of Commission Staff  
Dated January 19, 2010**

**Updated Response filed March 31, 2010**

**Question No. 55**

**Responding Witness: Shannon L. Charnas**

Q-55. Provide the following information concerning the costs for the preparation of this case:

a. A detailed schedule of expenses incurred to date for the following categories:

- (1) Accounting;
- (2) Engineering;
- (3) Legal;
- (4) Consultants; and
- (5) Other Expenses (Identify separately).

For each category, the schedule should include the date of each transaction, check number or other document reference, the vendor, the hours worked, the rates per hour, amount, a description of the services performed, and the account number in which the expenditure was recorded. Provide copies of any invoices, contracts, or other documentation that support charges incurred in the preparation of this rate case. Indicate any costs incurred for this case that occurred during the test year.

- b. An itemized estimate of the total cost to be incurred for this case. Expenses should be broken down into the same categories as identified in (a) above, with an estimate of the hours to be worked and the rates per hour. Include a detailed explanation of how the estimate was determined, along with all supporting workpapers and calculations.
- c. During the course of this proceeding, provide monthly updates of the actual costs incurred, in the manner requested in (a) above. Updates will be due the last business day of each month, through the month of the public hearing.

A-55. c. See attached.

KENTUCKY UTILITIES COMPANY

CASE NO. 2009-00548

Schedule of Rate Case Preparation Costs

Response to Commission's Order

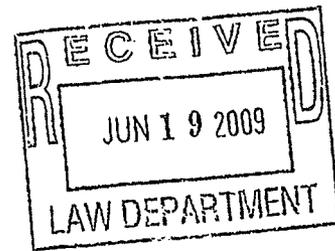
Dated January 19, 2010

Question No. 55(c)

Responding Witness: Shannon L. Charnas

Date	Invoice #	Vendor Name	Hours	Rate/Hr	Amount	Description	Account
18-Jun-09	621816	STOLL KEENON OGDEN PLLC	3.8	\$ 294.72	\$ 1,105.20	Professional Services	186023
20-Jul-09	623829	STOLL KEENON OGDEN PLLC	11.1	230.13	2,542.95	Professional Services	186023
26-Aug-09	627311	STOLL KEENON OGDEN PLLC	8.1	211.83	1,715.85	Professional Services	186023
21-Sep-09	629590	STOLL KEENON OGDEN PLLC	1.0	215.55	215.55	Professional Services	186023
29-Jan-10	640050	STOLL KEENON OGDEN PLLC	115.8	219.79	25,462.43	Professional Services	186023
		SUBTOTAL LEGAL OUTSIDE COUNSEL KU ELECTRIC			31,041.98		
		TOTAL LEGAL OUTSIDE COUNSEL KU ELECTRIC @ 12/31/09			53,560.81		186023
		<b>TOTAL LEGAL OUTSIDE COUNSEL KU ELECTRIC</b>			<b>84,602.79</b>		186023
7-Dec-09	2009121	THE PRIME GROUP LLC	33.0	179.55	5,925.00	Cost of service and rate design development	186023
5-Jan-10	20102	THE PRIME GROUP LLC	202.3	171.01	34,587.50	Cost of service and rate design development	186023
31-Dec-09	FINANC123109A	FINANCIAL CONCEPTS AND APPLICATIONS INC	14.7	257.63	3,800.00	Research, analysis & testimony preparation	186023
		SUBTOTAL CONSULTANTS KU ELECTRIC			44,312.50		
		TOTAL CONSULTANTS KU ELECTRIC @ 12/31/09			8,814.00		186023
		<b>TOTAL CONSULTANTS KU ELECTRIC</b>			<b>53,126.50</b>		186023
22-Jan-10	176817N	UNITED MAIL LLC			1,309.25	Rate case retiree letters	186023
22-Jan-10	176817T	UNITED MAIL LLC			478.95	Rate case retiree letters	186023
		SUBTOTAL SUPPLIES/SERVICES - OTHER KU ELECTRIC			1,788.20		
		TOTAL SUPPLIES/SERVICES - OTHER KU ELECTRIC @ 12/31/09			-		
		<b>TOTAL SUPPLIES/SERVICES - OTHER KU ELECTRIC</b>			<b>1,788.20</b>		186023
		<b>TOTAL RATE CASE EXPENSES @ 02/28/2010</b>			<b>\$ 139,517.49</b>		186023

**Stoll Keenon Ogden PLLC**  
 2000 PNC Plaza  
 500 West Jefferson Street  
 Louisville, Kentucky 40202-2828  
 502 333-6000  
 Tax ID # 61-0421389



E.ON U.S. LLC  
 Attn: Dorothy E O'Brien  
 220 West Main Street  
 Louisville, KY 40202

*Completed 40033*

June 18, 2009  
 Invoice #: 621816  
 Account #: 400001/134411

Please send your payment by July 18, 2009 to Stoll Keenon Ogden PLLC at:  
 P.O. Box 11969  
 Lexington, KY 40579-1969

Re: 2009 KY Base Rate Case  
 Your Reference: Responsible Attorney: Allyson Sturgeon  
 eCounsel No. 95126 *95123*

Fees rendered this bill	\$ 2,456.00
Less E.ON special discount	\$-245.60
<b>Total Current Charges This Matter</b>	<b>\$2,210.40</b>

**RECEIVED**

JUL 15 2009

ACCOUNTS PAYABLE

Estimate of 2009 Legal Fees and Disbursements/Expenses	\$302,500.00
2009 Cumulative Billed To Date	\$2,210.40
Variance Over/(Under)	(\$300,289.60)

Cumulative Value to Client of 2009 SKO Billing Adjustments (\$875.60)

*KU \$ 1105.20*  
*LGE-E 702.91*  
*LGE-G 402.29*  


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*\$ 2210.40*

*119615* OC-COM I \_\_\_\_\_ 0321 026900 =  
*119614* OC-ELEC I \_\_\_\_\_ 0321 026900 =

Keep this copy for your records.

Professional Services for the period through 05/31/09, including the following:

Re: 2009 KY Base Rate Case  
 Your Reference: Responsible Attorney: Allyson Sturgeon  
 eCounsel No. 95126

Our Reference: 400001/134411/KRR/1016

<u>Date</u>	<u>Description</u>	<u>Tkor</u>	<u>Hours</u>
04/13/09	Analysis of regulatory approvals for transfer of joint and common generation properties	KRR	0.30
04/13/09	Review TC2 Generation file re common facilities	RMW	0.40
04/14/09	Analysis of issue re transfer of assets and joint and common generation assets; prepare and send email to Ms. Sturgeon re same	KRR	1.50
04/14/09	Examine and revise advice re intercompany allocations; research	RMW	0.50
05/04/09	Telephone conference with Ms. Sturgeon and Mr. Conroy re depreciation issues.	KRR	0.30
05/08/09	Preparation for and attend meeting at E.ON with Ms. Sturgeon and accounting business re transfer of asset and allocation of property issues re next rate case and TC2	KRR	1.20
05/11/09	Attend meeting at E.ON re joint use of assets and regulatory issues.	KRR	1.00
05/29/09	Analysis of regulatory issues re allocation of property issues.	KRR	1.00
05/29/09	Analysis of cooling tower transfer.	WDC	1.30

**Total Services**

**\$2,456.00**

**RECEIVED**  
 JUL 15 2009  
**ACCOUNTS PAYABLE**

**Summary of Services**

<u>Init</u>	<u>Timekeeper</u>	<u>Hours</u>	<u>Rate</u>	<u>Value</u>
RMW	Watt, R M	0.90	350.00	315.00
KRR	Riggs, Kendrick R.	5.30	350.00	1,855.00
WDC	Crosby III, W D	1.30	220.00	286.00
	<b>Total Services</b>	<b>7.50</b>		<b>\$2,456.00</b>

**Keep this copy for your records.**

E:ON U.S. LLC

Stoll Keenon Ogden PLLC  
Invoice No. 621816

TOTAL FEES & DISBURSEMENTS	\$2,456.00
LESS DISCOUNT	\$-245.60
<b>Total Current Charges This Matter</b>	<b>\$2,210.40</b>

RECEIVED  
JUL 15 2009  
ACCOUNTS PAYABLE

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40033

**Stoll Keenon Ogden PLLC**  
2000 PNC Plaza  
500 West Jefferson Street  
Louisville, Kentucky 40202-2828  
502 333-6000  
Tax ID # 61-0421389

*Complete*

E.ON U.S. LLC  
Attn: Dorothy E O'Brien  
220 West Main Street  
Louisville, KY 40202

July 20, 2009  
Invoice #: 623829  
Account #: 400001/134411

**Please send your payment by August 19, 2009 to Stoll Keenon Ogden PLLC at:  
P.O. Box 11969  
Lexington, KY 40579-1969**

Re: 2009 KY Base Rate Case  
Your Reference: Responsible Attorney: Allyson Sturgeon  
eCounsel No. 95126 / 145723

Fees rendered this bill	\$ 5,651.00
Less E.ON special discount	\$-565.10
<b>Total Current Charges This Matter</b>	<b>\$ 5,085.90</b>

**RECEIVED**

JUL 27 2009

ACCOUNTS PAYABLE

Estimate of 2009 Legal Fees and Disbursements/Expenses	\$302,500.00
2009 Cumulative Billed To Date	\$7,296.30
Variance Over/(Under)	(\$295,203.70)
<hr/>	
Cumulative Value to Client of 2009 SKO Billing Adjustments	(\$1,440.70)

KU	2542.95
LGE-E	1617.32
LGE-G	925.63
	<hr/>
	5085.90

11/26/15	OC-COM <i>req</i>	0321	026900 =
11/26/15	OC-ELEC <i>req</i>	0321	026900 =

Keep this copy for your records.

Professional Services for the period through 06/30/09, including the following:

Re: 2009 KY Base Rate Case  
 Your Reference: Responsible Attorney: Allyson Sturgeon  
 eCounsel No. 95126

Our Reference: 400001/134411/KRR/1016

<u>Date</u>	<u>Description</u>	<u>Tkpr</u>	<u>Hours</u>
06/02/09	Telephone conference with Ms. Sturgeon re joint use of assets and transfer issues.	KRR	0.50
06/03/09	Memo to file re discussion of TC hyperbolic cooling tower ownership transfer and CPCN issues.	WDC	0.40
06/04/09	Memo to file re TC cooling tower transfer.	WDC	0.30
06/10/09	Telephone conference with Ms. Sturgeon and others re allocation of TC2/TC1 assets and regulatory issues re same.	KRR	1.00
06/11/09	Preparation for and telephone conference with Mr. Fendig and Ms. Sturgeon re allocation and TC2 property issues; telephone conference with Mr. Fendig re follow-up to same.	KRR	2.50
06/17/09	Analysis of transfer of joint and commonly owned property between LG&E and KU.	KRR	1.50
06/17/09	Draft letter to Commission regarding transfer of commonly owned facilities between KU and LG&E.	SKA	2.20
06/18/09	Research re transfer of cooling tower in TC2 generation CPCN proceeding; Research re corporate reorganization carve out of KRS 278.020; draft letter to Commission regarding transfer of commonly owned facilities between KU and LG&E.	SKA	4.10
06/19/09	Draft letter to PSC regarding transfer of TC2 assets from LG&E to KU; research re single "person" or "entity" and joint and common interest."	SKA	5.50
06/24/09	Revisions to letter to KPSC re TC2 asset transfers.	WDC	0.60
06/25/09	Preparation for and meeting at E.ON re joint asset allocation issues.	KRR	1.50
06/25/09	Meeting at E.ON re accounting for asset transfers; revisions to letter to KPSC re same.	WDC	1.70
06/30/09	Research re precedent for asset transfer between two related corporate entities.	SKA	0.30
<b>Total Services</b>			<b>\$5,651.00</b>

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 JUL 27 2009

ACCOUNTS PAYABLE

**Summary of Services**

<u>Init</u>	<u>Timekeeper</u>	<u>Hours</u>	<u>Rate</u>	<u>Value</u>
KRR	Riggs, Kendrick R.	7.00	350.00	2,450.00
WDC	Crosby III, W D	3.00	220.00	660.00
SKA	Adams, Sarah K. M.	12.10	210.00	2,541.00
Total Services		22.10		\$5,651.00

TOTAL FEES & DISBURSEMENTS	\$5,651.00
LESS DISCOUNT	\$-565.10
<b>Total Current Charges This Matter</b>	<b>\$5,085.90</b>

RECEIVED  
JUL 27 2009  
ACCOUNTS PAYABLE

*In Order*

**Stoll Keenon Ogden PLLC**  
2000 PNC Plaza  
500 West Jefferson Street  
Louisville, Kentucky 40202-2828  
502 333-6000  
Tax ID # 61-0421389  
*V# 40033*

E.ON U.S. LLC  
Attn: Dorothy E O'Brien  
220 West Main Street  
Louisville, KY 40202

August 26, 2009  
Invoice #: 627311  
Account #: 400001/134411

**Please send your payment by September 25, 2009 to Stoll Keenon Ogden PLLC at:**  
**P.O. Box 11969**  
**Lexington, KY 40579-1969**

Re: 2009 KY Base Rate Case  
Your Reference: Responsible Attorney: Allyson Sturgeon  
eCounsel No. 95126

Fees rendered this bill	\$ 3,813.00
Less E.ON special discount	\$-381.30
<b>Total Current Charges This Matter</b>	<b>\$ 3,431.70</b>

Estimate of 2009 Legal Fees and Disbursements/Expenses	\$302,500.00
2009 Cumulative Billed To Date	\$10,728.00
Variance Over/(Under)	(\$291,772.00)
<hr/>	
Cumulative Value to Client of 2009 SKO Billing Adjustments	(\$1,822.00)

*LGE - Corp*  
*KU - Corp*

*26419*

KU	1715.85
LGE-E	1091.28
LGE-G	624.57
	<u>3431.70</u>

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**SEP 04 2009**  
**ACCOUNTS PAYABLE**

Keep this copy for your records.

Professional Services for the period through 07/31/09, including the following:

Re: 2009 KY Base Rate Case  
 Your Reference: Responsible Attorney: Allyson Sturgeon  
 eCounsel No. 95126

Our Reference: 400001/134411/KRR/1016

<u>Date</u>	<u>Description</u>	<u>Tkpr</u>	<u>Hours</u>
07/01/09	Research re whether PSC approval required to transfer TC2 assets from LG&E to KU.	SKA	0.50
07/09/09	Draft memo re transfer of hyperbolic cooling tower.	SKA	0.60
07/13/09	Meeting at E.ON re TC2 asset transfer issues.	WDC	1.00
07/21/09	Work on transfer of asset issues.	KRR	1.00
07/21/09	Research re TC2-related asset transfers.	WDC	2.70
07/22/09	Comment on letter to KPSC re allocation of joint and common facilities.	KRR	1.00
07/22/09	Draft of letter to KPSC re TC asset transfers.	WDC	3.00
07/23/09	Draft of TC2 depreciation rate application.	WDC	0.50
07/24/09	Draft of application for TC2 depreciation rates.	WDC	1.90
07/27/09	Meeting at E.ON re letter to KPSC re TC asset transfer; draft of TC2 depreciation application.	WDC	2.80
07/28/09	Revisions to draft application for TC2 depreciation rates.	WDC	1.20
<b>Total Services</b>			<b>\$3,813.00</b>

<b>Summary of Services</b>					
<u>Init</u>	<u>Timekeeper</u>	<u>Hours</u>	<u>Rate</u>	<u>Value</u>	
KRR	Riggs, Kendrick R.	2.00	350.00	700.00	
WDC	Crosby III, W D	13.10	220.00	2,882.00	
SKA	Adams, Sarah K. M.	1.10	210.00	231.00	
<b>Total Services</b>		<b>16.20</b>		<b>\$3,813.00</b>	

E.ON U.S. LLC

Stoll Keenon Ogden PLLC  
Invoice No. 627311

TOTAL FEES & DISBURSEMENTS	\$3,813.00
LESS DISCOUNT	\$-381.30
<b>Total Current Charges This Matter</b>	<b>\$3,431.70</b>

**Keep this copy for your records.**

*L. O'Brien*  
**Stoll Keenon Ogden PLLC**  
2000 PNC Plaza  
500 West Jefferson Street  
Louisville, Kentucky 40202-2828  
502 333-6000  
Tax ID # 61-0421389

*V# 40033*

E.ON U.S. LLC  
Attn: Dorothy E O'Brien  
220 West Main Street  
Louisville, KY 40202

September 21, 2009  
Invoice #: 629590  
Account #: 400001/134411

Please send your payment by October 21, 2009 to Stoll Keenon Ogden PLLC at:  
P.O. Box 11969  
Lexington, KY 40579-1969

Re: 2009 KY Base Rate Case  
Your Reference: Responsible Attorney: Allyson Sturgeon  
eCounsel No. 95126

Fees rendered this bill	\$ 479.00
Less E.ON special discount	\$-47.90
<b>Total Current Charges This Matter</b>	<b>\$ 431.10</b>

Estimate of 2009 Legal Fees and Disbursements/Expenses	\$302,500.00
2009 Cumulative Billed To Date	\$11,159.10
Variance Over/(Under)	(\$291,340.90)
Cumulative Value to Client of 2009 SKO Billing Adjustments	(\$1,869.90)

KU	215.55
LGE-E	137.09
LGE-G	78.46
	<hr/>
	431.10

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OCT 06 2009  
ACCOUNTS PAYABLE

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Professional Services for the period through 08/31/09, including the following:

Re: 2009 KY Base Rate Case  
 Your Reference: Responsible Attorney: Allyson Sturgeon  
 eCounsel No. 95126

Our Reference: 400001/134411/KRR/1016

<u>Date</u>	<u>Description</u>	<u>Tkpr</u>	<u>Hours</u>
08/03/09	Meeting re TC2 depreciation filing; preparation for same.	WDC	1.30
08/05/09	Review and comment on draft depreciation application.	KRR	0.30
08/05/09	Revisions to draft TC2 depreciation application.	WDC	0.40
<b>Total Services</b>			<b>\$479.00</b>

<b>Summary of Services</b>					
<u>Init</u>	<u>Timekeeper</u>	<u>Hours</u>	<u>Rate</u>	<u>Value</u>	
KRR	Riggs, Kendrick R.	0.30	350.00	105.00	
WDC	Crosby III, W D	1.70	220.00	374.00	
<b>Total Services</b>		<b>2.00</b>		<b>\$479.00</b>	

<b>TOTAL FEES &amp; DISBURSEMENTS</b>	<b>\$479.00</b>
<b>LESS DISCOUNT</b>	<b>\$-47.90</b>
<b>Total Current Charges This Matter</b>	<b>\$431.10</b>

RECEIVED

OCT 06 2009

ACCOUNTS PAYABLE

*In Ough*  
**Stoll Keenon Ogden PLLC**  
 2000 PNC Plaza  
 500 West Jefferson Street  
 Louisville, Kentucky 40202-2828  
 502 333-6000  
 Tax ID # 61-0421389

V# 40033

2009

E.ON U.S. LLC  
 Attn: Dorothy E O'Brien  
 220 West Main Street  
 Louisville, KY 40202

January 29, 2010  
 Invoice #: 640050  
 Account #: 400001/134411

Please send your payment by February 28, 2010 to Stoll Keenon Ogden PLLC at:  
 P.O. Box 11969  
 Lexington, KY 40579-1969

Re: 2009 KY Base Rate Case  
 Your Reference: Responsible Attorney: Allyson Sturgeon  
 eCounsel No. 27749

Fees rendered this bill	\$ 56,477.00
Less E.ON special discount	\$-5,647.70
Disbursements	\$ 95.55
<b>Total Current Charges This Matter</b>	<b>\$ 50,924.85</b>

**RECEIVED**

FEB 12 2010

<b>Estimate of 2009 Legal Fees and Disbursements/Expenses</b>	<del>\$302,500.00</del>
<b>2009 Cumulative Billed To Date</b>	<del>\$169,205.58</del>
<b>Variance Over/(Under)</b>	<del>(\$133,294.42)</del>
<b>Cumulative Value to Client of 2009 SKO Billing Adjustments</b>	<del>(\$19,384.49)</del>

125973	KU RATECASE 2010	0321	026900 =	25462.43
125974	LGE RC-EL 2010	0321	026900 =	9268.32
125975	LGE RC-GS 2010	0321	026900 =	16194.10
				50924.85

Keep this copy for your records.

Professional Services for the period through 12/31/09, including the following:

Re: 2009 KY Base Rate Case  
Your Reference: Responsible Attorney: Allyson Sturgeon  
eCounsel No. 27749

Our Reference: 400001/134411/KRR/1016

<u>Date</u>	<u>Description</u>	<u>Tkpr</u>	<u>Hours</u>
12/01/09	Work on testimony.	KRR	2.00
12/01/09	Draft Thompson and Hermann testimonies	MLB	7.00
12/01/09	Review data request response and order from EKPC case; e-mail to Spanos et al re Spanos rebuttal in TC2 depreciation case	RMW	1.00
12/01/09	Examine comments from Messrs. Cornett and Murphy re Hermann; examine and revise Hermann testimony	RMW	1.00
12/01/09	Revisions to testimony.	WDC	4.90
12/02/09	Attention to testimony.	KRR	0.50
12/02/09	Draft Thompson and Hermann testimonies; research consolidated tax issues	MLB	4.30
12/02/09	Examine Spanos testimony and e-mail to Spanos	RMW	1.00
12/02/09	Meeting re Wolfram testimony; revisions to testimony.	WDC	2.10
12/03/09	Work on testimony	KRR	1.00
12/03/09	Draft Thompson testimony; consolidated tax research	MLB	4.70
12/04/09	Work on testimony.	KRR	1.00
12/04/09	Draft memorandum regarding consolidated tax issues	MLB	4.20
12/05/09	Work on testimony.	KRR	1.00
12/06/09	Work on testimony.	KRR	1.00
12/06/09	Revisions to testimony.	WDC	2.70
12/07/09	Meeting at E.ON re revenue requirements and regulatory issues; meeting re depreciation issues.	KRR	2.00
12/07/09	Reviewing and editing testimony	MLB	1.20
12/07/09	Revisions to draft testimony.	WDC	5.80
12/08/09	Draft Hermann testimony	MLB	3.30
12/08/09	Research re ECR roll-in.	WDC	5.70
12/09/09	Draft Hermann and Thompson testimonies	MLB	3.40

**Keep this copy for your records.**

<u>Date</u>	<u>Description</u>	<u>Tkpr</u>	<u>Hours</u>
12/09/09	Research re regulatory issue.	WDC	1.20
12/13/09	Draft Hermann testimony	MLB	0.90
12/14/09	Prepare for and attend meeting at E.ON re revenue requirement issues.	KRR	1.50
12/14/09	Attended revenue requirement meeting; drafted Hermann, Thompson, Scott and Charnas testimonies	MLB	9.10
12/14/09	Meetings at E ON re testimony and revenue requirement.	WDC	5.60
12/15/09	Email correspondence and begin assembly of documents regarding deed transfer of TC2 joint use assets	JWH	0.90
12/15/09	Prepare for and attend meetings at E.ON re testimonies and follow-up on same.	KRR	2.00
12/15/09	Attended Scott and Charnas testimonies review meeting; drafted Thompson, Scott and Charnas testimonies	MLB	6.30
12/15/09	Work on deed for Trimble County facilities.; review memo and e-mail chains re same; began drafting deed form.	TLS	1.00
12/15/09	Revisions to draft testimony.	WDC	1.50
12/16/09	Prepare property description and lists for transfer; telephone call with Mr. Fendig.	JWH	2.20
12/16/09	Work on testimony	KRR	1.00
12/16/09	Draft Scott and Charnas testimonies.	MLB	3.90
12/16/09	Research re Joint Use Asset Deed transfers; reviewed prior deeds and participation agreements re same.	TLS	1.10
12/16/09	Revisions to draft testimony.	WDC	2.70
12/17/09	Attention to testimony and depreciation issues.	KRR	1.50
12/17/09	Draft Hermann, Thompson, Scott and Charnas testimonies.	MLB	5.30
12/17/09	Continued draft of LG&E Deed to KU for Trimble Joint Use Assets - reviewed Participation Agreements re same.	TLS	1.70
12/17/09	Revisions to rate case testimony.	WDC	4.10
12/18/09	Email regarding TC2 issues and analysis regarding same.	JWH	0.70
12/18/09	Work on testimony.	KRR	4.00
12/18/09	Draft Scott, Charnas and Thompson testimonies; participate in conference call with Ms. Sturgeon and Mr. Conroy	MLB	4.60
12/18/09	Examine Thompson testimony, conference call with Ms. Sturgeon et al re same	RMW	1.50

**Keep this copy for your records.**

<u>Date</u>	<u>Description</u>	<u>Tkpr</u>	<u>Hours</u>
12/18/09	E-mails from Mr. Fendig re Joint Use Assets/transfer issues; reviewed summary of Joint Use Assets; e-mail to group re same and real property interests; drafted Bill of Sale for personal property items; reviewed Participation Agreements re transfers.	TLS	1.80
12/18/09	Revisions to testimony.	WDC	7.40
12/19/09	Work on testimony.	KRR	1.30
12/19/09	Revisions to testimony.	WDC	4.80
12/20/09	Work on testimony.	KRR	5.50
12/20/09	Draft Scott, Charnas and Staffieri testimonies.	MLB	2.10
12/20/09	Revisions to testimony.	WDC	9.20
12/21/09	Prepare for and telephone call with Ms. Sturgeon and Messrs. Fendig and Dimas regarding TC2 transfer issue; review and comment on deed and Bill of Sale.	JWH	1.20
12/21/09	Work on testimony.	KRR	7.50
12/21/09	Draft Thompson, Scott, Charnas and Staffieri testimonies.	MLB	5.90
12/21/09	Examine and revise Thompson testimony; examine and give comments on Bellar's KU and LG&E testimony; review post-test year adjustments	RMW	4.00
12/21/09	Continued review of Joint Asset lists and information on title transfers; participated in conference call re same; revised Deed and Bill of Sale	TLS	2.30
12/21/09	Revisions to testimony.	WDC	6.90
12/22/09	Work on testimony issues.	KRR	2.00
12/22/09	Prepare a binder for witness testimony; prepare a list of items for which source data is still needed and sending said list to Mr. Cornett	MLB	4.30
12/22/09	Revisions to draft testimony.	WDC	3.00
12/23/09	Email correspondence regarding TC2 deed and Bill of Sale, review changes to same.	JWH	0.90
12/23/09	Work on testimony, brief review of PSC Order re interim depreciation rates	KRR	1.20
12/23/09	E-mails to/from Mr. Dimas and Mr. Fendig re joint assets transfer documents; revised Deed and Bill of Sale	TLS	1.60
12/23/09	Revisions to draft testimony.	WDC	1.50
12/28/09	Review KPSC order re depreciation; review KIUC filing re depreciation issues; attention to testimony.	KRR	1.00

**Keep this copy for your records.**

<u>Date</u>	<u>Description</u>	<u>Tkpr</u>	<u>Hours</u>
12/28/09	Draft Staffieri testimony.	MLB	5.10
12/28/09	Revisions to draft testimony.	WDC	0.80
12/29/09	Attention to testimony issues.	KRR	1.00
12/29/09	Draft Staffieri and Thompson testimonies	MLB	1.10
12/29/09	Examine and revise KU and LG&E Electric tariffs; examine bill insert and research regulations; e-mail re tariffs and bill insert	RMW	6.00
12/30/09	Review proposed changes to Deed and Bill of Sale transferring interest in joint use assets to KU; email regarding same.	JWH	0.40
12/30/09	Prepare testimony back-up binder for witness	MLB	4.70
12/30/09	Begin to prepare testimony back-up binder for client	MMS	3.20
12/31/09	Prepare backup testimony binder for witness	MLB	4.70
12/31/09	Work on testimony back-up binder for client and prepare table of contents for same	MMS	1.20
12/31/09	Examine and comment on Avera testimony	RMW	3.00

**Total Services****\$56,477.00****Summary of Services**

<u>Init</u>	<u>Timekeeper</u>	<u>Hours</u>	<u>Rate</u>	<u>Value</u>
RMW	Watt, R M	17.50	350.00	6,125.00
MMS	Stephens, M M	4.40	145.00	638.00
MLB	Braun, Monica	86.10	190.00	16,359.00
JWH	Hendricks, J W	6.30	290.00	1,827.00
KRR	Riggs, Kendrick R.	38.00	350.00	13,300.00
TLS	Schnell, A L	9.50	300.00	2,850.00
WDC	Crosby III, W D	69.90	220.00	15,378.00
	<b>Total Services</b>	<b>231.70</b>		<b>\$56,477.00</b>

**Disbursements**

<u>Date</u>	<u>Description</u>	<u>Tkpr</u>	<u>Amount</u>
10/28/09	Telephone Expense 1(973)648-2350; 8 Mins.	JDP	\$1.52
10/28/09	Telephone Expense 1(973)648-2100; 2 Mins.	JDP	\$0.38
10/29/09	Telephone Expense 1(973)648-3426; 6 Mins.	JDP	\$1.14
10/29/09	Telephone Expense 1(973)648-4770; 5 Mins.	JDP	\$0.95
11/18/09	Telephone Expense 1(973)648-2350; 3 Mins.	JDP	\$0.57

**Keep this copy for your records.**

E ON U.S. LLC

Stoll Keenon Ogden PLLC  
Invoice No. 640050

11/18/09	Telephone Expense 1(973)648-2350; 12 Mins.	JDP	\$2.28
12/04/09	Telephone Expense 1(717)763-7212; 2 Mins.	EKC	\$0.38
12/04/09	Telephone Expense 1(717)763-7211; 4 Mins.	EKC	\$0.76
12/04/09	Federal Express Charges		\$10.57
12/14/09	Duplicating Charges		\$38.00
12/23/09	VENDOR: Central Bank & Trust Co.; INVOICE#: 122309; DATE: 12/23/2009		\$39.00
<b>Total Disbursements</b>			<b>\$95.55</b>

**Summary of Disbursements**

<u>Disb Code</u>	<u>Description</u>	<u>Amt</u>
002	Duplicating Charges	\$38.00
004	Federal Express Charges	\$10.57
005	Telephone Expense	\$7.98
079	Outside Duplicating Charges	\$39.00
	<b>Total Disbursements</b>	<b>\$95.55</b>

TOTAL FEES & DISBURSEMENTS	\$56,572.55
LESS DISCOUNT	\$-5,647.70
<b>Total Current Charges This Matter</b>	<b>\$50,924.85</b>

**Keep this copy for your records.**

# The Prime Group

## Invoice for Services Rendered

*Complete*

Invoice Date: December 7, 2009

ENTERED  
2/2/10



Invoice Number 200912-1

To: E.ON  
P.O. Box 32010  
Louisville, KY 40232

Attn: Mr. Robert Conroy

39.0 hours of consulting work by Steve Seelye @ \$200.00/hr performed during an LG&E and KU rate case in Kentucky for E.ON.

\$ 7,800.00

27.0 hours of consulting work by Jeff Wernert @ \$150.00/hr performed during an LG&E and KU rate case in Kentucky for E.ON.

\$ 4,050.00

*\$11850.00*

24.0 hours of consulting work by Steve Seelye @ \$200.00/hr performed during November in providing support for a retail rate case in Virginia for E.ON.

\$ 4,800.00

Total due for November

\$ 16,650.00

Please remit payment to:

**The Prime Group, LLC**  
P.O. Box 837  
Crestwood, KY 40014-0837

*[Handwritten signature]* 2/1/10

PO# 41599

KU 5925.00  
LGEE 3768.30  
LGEG 2156.70  

---

\$11850.00

RECEIVED  
FEB 02 2010  
ACCOUNTS PAYABLE

# The Prime Group

## Invoice for Services Rendered

Invoice Date: January 5, 2010

Invoice Number 2010-2

RECEIVED

FEB 10 2010

To: E.ON  
P.O. Box 32010  
Louisville, KY 40232

ACCOUNTS PAYABLE

Attn: Mr. Robert Conroy

170.0 hours of consulting work by Steve Seelye @ \$200.00/hr performed during December in providing support for a retail rate case for LG&E and KU in Kentucky for E.ON. \$ 34,000.00

56.5 hours of consulting work by Paul Garcia @ \$150.00/hr performed during December in providing support for a retail rate case for LG&E and KU in Kentucky for E.ON. \$ 8,475.00

99.5 hours of consulting work by Eric Blake @ \$150.00/hr performed during December in providing support for a retail rate case for LG&E and KU in Kentucky for E.ON. \$ 14,925.00

78.5 hours of consulting work by Jeff Wernert @ \$150.00/hr performed during December in providing support for a retail rate case for LG&E and KU in Kentucky for E.ON. \$ 11,775.00

Total due for December \$ 69,175.00

Please remit payment to: The Prime Group, LLC  
P.O. Box 837  
Crestwood, KY 40014-0837

PO# 35361



KY Rate Case

Line 4 (KU RC) - 34,587.50

Line 5 (LGE Elec RC) - 21,997.65

Line 6 (LGE Gas RC) - 12,589.85

The Prime Group, LLC  
P. O. Box 837 • Crestwood, KY • 40014-0837  
Phone 502-425-7882 FAX 502-326-9894

2010

69,175.00

FINANCIAL CONCEPTS AND APPLICATIONS, INC.  
3907 RED RIVER  
AUSTIN, TEXAS 78751

(512) 458-4644

fincap@texas.net  
Fax (512) 458-4768

December 31, 2009

Mr. Rick Lovekamp  
E.ON U.S.  
Post Office Box 32010  
Louisville, Kentucky 40232

Reference No.: 01856  
Taxpayer ID No.: 74-2058652

Consulting Services:

Research, Analysis, and Testimony  
Preparation in Connection with Rate  
Case before the Kentucky Public Ser-  
vice Commission Pursuant to E.ON  
U.S. Contract No. 25561. (For the  
Period through December 31, 2009

Professional Time:

William E. Avera	
1½ hours	\$ 600
Adrien M. McKenzie	
28 hours	7,000

Total

\$ 7,600

Approved by:  
*Rick Lovekamp*  
Mgn. Reg. Affairs  
01-11-10

*Bruce H. Fairchild*

Bruce H. Fairchild

RECEIVED  
FEB 02 2010  
ACCOUNTS PAYABLE

PO# 41602

KU	\$ 3800.00
LGEE	2416.80
LGEG	1383.20
	<hr/>
	\$ 7600.00

# UnitedMail

4410 Bishop Lane, Louisville, KY 40218  
 502-485-1400 PH 502-657-4772 FX  
 www.united-mail.com

KIMBERLY WHITCOMB  
 E ON US  
 220 W MAIN ST  
 2ND FLOOR  
 LOUISVILLE, KY 40202-1395

*13669-137  
 1/21*

Invoice Date	Invoice No.
01/22/2010	176817N
Customer No.	Customer PO
LG&EKW	

REMIT TO: UNITED MAIL  
 4410 BISHOP LANE, SUITE 100  
 LOUISVILLE, KY 40218-4506

Total Due
\$ 2,618.51

TERMS: NET 10 DAYS

Job Name	Rate Case Retiree	Ordered By	Kimberly Whitcomb
----------	-------------------	------------	-------------------

Description	Quantity	Price	Amount
Mail Processing	3,193		\$1,320.34
Data Entry			\$0.30
Laser Setup			\$75.00
NCOA			\$75.00
Postage Permit			\$1,147.87

*Kim Whitcomb*

RECEIVED

FEB 01 2010

ACCOUNT'S PAYABLE

*KO \$1309.25  
 LGEE 832.69  
 LGEG 476.57  
 \$2618.51*

Net Invoice: \$2,618.51

Sales Tax: \$0.00

Invoice Total \$2,618.51

**BALANCE DUE WITHIN 10 DAYS**  
 Late payment charge of 1.5% per month

# UnitedMail

4410 Bishop Lane, Louisville, KY 40218  
502-485-1400 PH 502-657-4772 FX  
www.united-mail.com

KIMBERLY WHITCOMB  
E ON US  
220 W MAIN ST  
2ND FLOOR  
LOUISVILLE, KY 40202-1395

13669-137  
line 2

Invoice Date	Invoice No.
01/22/2010	176817T
Customer No.	Customer PO
LG&EKW	

REMIT TO: UNITED MAIL  
4410 BISHOP LANE, SUITE 100  
LOUISVILLE, KY 40218-4506

Total Due  
\$ 957.90

TERMS: NET 10 DAYS

Job Name	Rate Case Retiree	Ordered By	Kimberly Whitcomb
----------	-------------------	------------	-------------------

Description	Quantity	Price	Amount
Duplex - page 1 & 2	3,193	0.1200	\$383.16
Duplex - page 3 & 4	3,193	0.1200	\$383.16
Simplex - page 5	3,193	0.0600	\$191.58

*Kim Whitcomb*

RECEIVED

FEB 01 2010

ACCOUNTS PAYABLE

KO \$478.95  
LGEE 304.61  
LGE G 174.34  

---

\$957.90

**BALANCE DUE WITHIN 10 DAYS**  
Late payment charge of 1.5% per month

Net Invoice: \$957.90

Sales Tax: \$0.00

Invoice Total \$957.90

**KENTUCKY UTILITIES COMPANY**

**CASE NO. 2009-00548**

**UPDATED Response to Attorney General's Initial Requests for Information  
Dated March 1, 2010**

**Updated Response filed March 31, 2010**

**Question No. 188**

**Responding Witness: Valerie L. Scott**

- Q-188. Please provide copies of the financial statements (balance sheet, income statement, statement of cash flows, and the notes to the financial statements) for KU, E.ON U.S. LLC, and E.ON AG for the past 2007 and 2008. Please include 2009 financial statements when they become available. Please provide copies of the financial statements in both hard copy and electronic (Microsoft Excel) formats, with all data and formulas intact.
- A-188. The KU and E.ON U.S. LLC 2009 financial statements are attached.

**Kentucky Utilities Company**

**Financial Statements and Additional Information**

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

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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
EEI	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
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)
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 and 2008, were as follows:

	2009		2008	
	Revenues (millions)	Volumes (Gwh)	Revenues (millions)	Volumes (Gwh)
Residential	\$ 480	6,594	\$ 462	6,803
Industrial & Commercial	637	10,171	636	10,709
Municipals	91	1,848	92	1,971
Other Retail	118	1,647	108	1,707
Wholesale	29	660	107	2,894
Total	<u>\$ 1,355</u>	<u>20,920</u>	<u>\$ 1,405</u>	<u>24,084</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	<u>71</u>
Total Steam Stations	2,849
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	<u>36</u>
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.

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>\$ 1,273</u>	<u>\$ 1,210</u>	<u>\$ 1,207</u>
Net operating income	<u>\$ 269</u>	<u>\$ 260</u>	<u>\$ 268</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 and 2008 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).

#### 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

## 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)

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

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

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

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

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.

## 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)

## 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.

## Financing Activities

Net cash provided by financing activities decreased \$151 million 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.

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)	Payments Due by Period						
	2010	2011	2012	2013	2014	Thereafter	Total
<u>Contractual Cash Obligations</u>							
Short-term debt (a)	\$ 45	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 45
Long-term debt	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)	<u>57</u>	<u>5</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>62</u>
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>
OPERATING REVENUES:		
Total operating revenues (Note 11).....	\$ 1,355	\$ 1,405
OPERATING EXPENSES:		
Fuel for electric generation .....	434	513
Power purchased (Notes 9 and 11).....	199	221
Other operation and maintenance expenses .....	320	275
Depreciation and amortization (Note 1).....	<u>133</u>	<u>136</u>
Total operating expenses.....	<u>1,086</u>	<u>1,145</u>
Net operating income.....	269	260
Equity in earnings of EEI (Note 1) .....	(1)	(30)
Other expense/(income) - net .....	(5)	(8)
Interest expense (Notes 7 and 8).....	6	14
Interest expense to affiliated companies (Notes 8 and 11) .....	<u>69</u>	<u>58</u>
Income before income taxes .....	200	226
Federal and state income taxes (Note 6).....	<u>67</u>	<u>68</u>
Net income.....	<u>\$ 133</u>	<u>\$ 158</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>
Balance January 1 .....	\$ 1,195	\$ 1,037
Add net income.....	<u>133</u>	<u>158</u>
Balance December 31 .....	<u>\$ 1,328</u>	<u>\$ 1,195</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	27	32
as of December 31, 2009 and 2008 .....		
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) .....	<u>12</u>	<u>23</u>
Utility plant, at original cost (Note 1): .....	4,892	4,446
Less: reserve for depreciation .....	<u>1,838</u>	<u>1,724</u>
Total utility plant, net .....	3,054	2,722
Construction work in progress .....	<u>1,257</u>	<u>1,176</u>
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.....	<u>42</u>	<u>34</u>
Total current liabilities.....	<u>568</u>	<u>497</u>
<b>Long-term debt:</b>		
Long-term bonds (Note 7).....	123	123
Long-term debt to affiliated company (Notes 7 and 11).....	<u>1,298</u>	<u>1,181</u>
Total long-term debt.....	<u>1,421</u>	<u>1,304</u>
<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.....	<u>21</u>	<u>26</u>
Total deferred credits and other liabilities.....	<u>1,015</u>	<u>973</u>
<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.....	<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 Liabilities and Equity.....	<u>\$ 4,956</u>	<u>\$ 4,518</u>

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>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income .....	\$ 133	\$ 158
Items not requiring cash currently:		
Depreciation and amortization.....	133	136
Deferred income taxes - net.....	50	(13)
Investment tax credit - net .....	24	25
Provision for pension and postretirement plans.....	26	10
Other .....	-	1
Change in certain current assets and liabilities:		
Accounts receivable.....	(4)	12
Materials and supplies .....	(28)	(33)
Prepayments and other current assets .....	(3)	(1)
Accounts payable.....	(3)	9
Other current liabilities .....	8	5
Pension and postretirement funding.....	(20)	(5)
Storm restoration regulatory asset.....	(57)	(2)
Other.....	(6)	(10)
Net cash provided by operating activities.....	<u>253</u>	<u>292</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Construction expenditures .....	(516)	(686)
Assets purchased from affiliate.....	-	(10)
Change in restricted cash .....	9	1
Net cash used for investing activities .....	<u>(507)</u>	<u>(695)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Long-term borrowings from affiliated company (Note 7).....	150	250
Short-term borrowings from affiliated company – net (Note 8) .....	29	(7)
Issuance of pollution control bonds .....	-	77
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
Net cash provided by financing activities.....	<u>254</u>	<u>405</u>
Change in cash and cash equivalents.....	-	2
Cash and cash equivalents at beginning of year .....	2	-
Cash and cash equivalents at end of year .....	<u>\$ 2</u>	<u>\$ 2</u>
<b>Supplemental disclosures of cash flow information:</b>		
Cash paid during the year for:		
Income taxes .....	\$ (9)	\$ 46
Interest on borrowed money .....	3	13
Interest to affiliated companies on borrowed money.....	67	53

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 %.....	78	78
Total pollution control series .....	<u>351</u>	<u>351</u>
Notes payable to Fidelia:		
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.....	75	75
Total notes payable to Fidelia .....	<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.....	10	21
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, cash from operations was decreased by \$5 million and cash flows from investing increased by \$5 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 and 3.0% in 2008 of average depreciable plant. Of the amount provided for depreciation at December 31, 2009 and 2008, approximately 0.4% and 0.5%, respectively, 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 and \$60 million at December 31, 2009 and 2008, 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	<u>1</u>	<u>4</u>
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	<u>7</u>	<u>2</u>
Subtotal non-current regulatory assets	117	64
Pension benefits	<u>105</u>	<u>137</u>
Total non-current regulatory assets	<u>\$ 222</u>	<u>\$ 201</u>
Current regulatory liabilities:		
DSM	<u>\$ 3</u>	<u>\$ 5</u>
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	<u>11</u>	<u>15</u>
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, 2007	\$ 5	\$ (30)	\$ 24	\$ (2)	\$ 2	\$ 1
ARO accretion	-	(2)	2	-	-	-
Removal cost reclass	-	-	2	(2)	-	-
As of December 31, 2008	<u>5</u>	<u>(32)</u>	<u>28</u>	<u>(4)</u>	<u>2</u>	<u>1</u>
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 and 2008 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 year ended December 31, 2008, 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 and June 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 and October 2007, respectively. In January 2009, the Kentucky Commission initiated a routine examination of the FAC for the two-year period 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, 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 EPCRA 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 or 2008. 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 Mwbs and 146,000 Mwbs, 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) December 31, 2009	Location of Gain (Loss) Recognized in <u>Income on Derivatives</u>	Amount of Gain (Loss) Recognized in <u>Income on Derivatives</u>
Energy trading and risk management contracts (unrealized)	Electric revenues	\$ (1)
Total		<u>\$ (1)</u>
December 31, 2008		
Energy trading and risk management contracts (unrealized)	Electric revenues	\$ 1
Total		<u>\$ 1</u>

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

#### **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 and 2008, 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	\$ 4
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	\$ 75
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	\$ -	\$ -	\$ -	\$ 1
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% and 46% of E.ON U.S. Services' total cost for 2009 and 2008, respectively.

(in millions)

	<u>Pension Benefits</u>											
	E.ON U.S. Services Allocation to KU		Total KU	E.ON U.S. Services Allocation to KU		Total KU						
	<u>KU</u>	<u>2009</u>	<u>2009</u>	<u>KU</u>	<u>2008</u>	<u>2008</u>						
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 costs		1		1		2		1		1		2
Amortization of actuarial loss		9		2		11		-		-		-
Benefit cost at end of year	<u>\$</u>	<u>19</u>	<u>\$</u>	<u>11</u>	<u>\$</u>	<u>30</u>	<u>\$</u>	<u>4</u>	<u>\$</u>	<u>6</u>	<u>\$</u>	<u>10</u>

Other Postretirement Benefits

	<u>Other Postretirement Benefits</u>											
	E.ON U.S. Services Allocation to KU		Total KU	E.ON U.S. Services Allocation to KU		Total KU						
	<u>KU</u>	<u>2009</u>	<u>2009</u>	<u>KU</u>	<u>2008</u>	<u>2008</u>						
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 transitional obligation		1		-		1		1		-		1
Benefit cost at end of year	<u>\$</u>	<u>6</u>	<u>\$</u>	<u>1</u>	<u>\$</u>	<u>7</u>	<u>\$</u>	<u>6</u>	<u>\$</u>	<u>1</u>	<u>\$</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)	Pension <u>Benefits</u>	Other Postretirement <u>Benefits</u>
Regulatory assets/liabilities:		
Net actuarial loss	\$ 6	\$ -
Prior service cost	1	1
Transition obligation	<u>-</u>	<u>1</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>
Discount rate	6.25%	6.66%
Expected long-term return on plan assets	8.25%	8.25%
Rate of compensation increase	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. The Company also made contributions to other postretirement benefit plans of \$7 million and \$5 million in 2009 and 2008, 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 both 2009 and 2008.

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 and in 2008.

## 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 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 as of December 31, 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 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>
Current - federal	\$ (5)	\$ 46
- state	1	10
Deferred - federal – net	43	(10)
- state – net	7	(3)
Investment tax credit – deferred	21	25
Total income tax expense	<u>\$ 67</u>	<u>\$ 68</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.

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 and \$25 million in 2009 and 2008, 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	69	40
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	18	22
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	336	279
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>
Statutory federal income tax rate	35.0 %	35.0 %
State income taxes, net of federal benefit	2.7	2.6
Reduction of income tax reserve	-	(0.2)
Qualified production activities deduction	(0.3)	(1.1)
Dividends received deduction related to EEI investment	(1.5)	(4.2)
Reversal of excess deferred taxes	(0.9)	(0.6)
Other differences	<u>(1.5)</u>	<u>(1.4)</u>
Effective income tax rate	<u>33.5 %</u>	<u>30.1 %</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.

### 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 and 2008 was 0.61% and 1.75%, 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 and 2008, the average rate on the auction rate bonds was 0.44% and 4.50%, 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>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>
<u>Tax Exempt Bond Issues</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 and 2008 was 0.61% and 1.75%, respectively.

There were no redemptions or maturities of long-term debt for 2009. Redemptions and maturities of long-term debt for 2008 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

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

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

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, Fidelia, 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	<u>1,324 (a)</u>
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 and \$9 million for 2009 and 2008, 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	<u>3</u>
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>
Electric operating revenues from LG&E	\$ 21	\$ 80
Power purchased from LG&E	101	109

##### 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>
Interest on money pool loans	\$ -	\$ 2
Interest on Fidelity loans	69	56

##### 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>
E.ON U.S. Services billings to KU	\$ 169	\$ 227
LG&E billings to KU	44	5
KU billings to E.ON U.S. Services	14	3
KU billings to LG&E	78	75

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, KU received capital contributions from its common shareholder, E.ON U.S., totaling \$145 million.

#### **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 the years then ended 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 21 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