Duke Energy®

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Dianne B. Kuhnell.
Senior Paralegal

VIA OVERNIGHT DELIVERY

May 28, 2009

Mr. Jeff Cline
Public Service Commission
Commonwealth of Kentucky
211 Sower Boulevard
Frankfort, Kentucky 40602-0615

Re: In the Matter of an Adjustment of Gas Rates of The Union Light, Heat and Power Company, Case No. 2001-00092; and

In the Matter of the Joint Application of Duke Energy Corporation, Duke Energy Holding Corp., Deer Acquisition Corp., Cougar Acquisition Corp., Cinergy Corp., The Cincinnati Gas & Electric Company and The Union Light, Heat and Power Company for Approval of a Transfer and Acquisition of Control, Case No. 2005-00228.

Dear Mr. Cline:

I have enclosed Duke Energy Kentucky, Inc.'s First Quarter 2009 jurisdictional financial statements per order by the Commission in the above-referenced cases.

Please file-stamp the extra copy of this letter and return to me in the enclosed return-addressed envelope.

If you have any questions regarding the financial statements, please contact Ms. Brenda Melendez, Manager, Accounting at (513) 287-1554.

Very truly yours,

Dianne B. Kuhnell

Dianne B. Kuhnell.
Senior Paralegal

Enclosure

cc: Ms. Brenda Melendez

259967

Duke Energy Kentucky, Inc.

Financial Statements

(Unaudited)

March 31, 2009

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF OPERATIONS
(UNAUDITED)

	Year To Date March 31, 2009	2008
	(in thousands)	
Operating Revenues		
Electric	$ **81,871**	$ 76,681
Gas	**57,535**	72,601
Other	**5,639**	5,197
Total Operating Revenues	**145,045**	154,479
Operating Expenses		
Natural gas purchased	**40,054**	55,916
Operation, maintenance and other	**31,635**	31,280
Fuel used in electric generation and purchased power	**36,654**	33,357
Depreciation and amortization	**10,768**	8,044
Property and other taxes	**3,505**	3,113
Total Operating Expenses	**122,616**	131,710
Operating Income	**22,429**	22,769
Other Income and Expenses, net	**815**	1,416
Interest Expense	**4,588**	4,220
Income Before Income Taxes	**18,656**	19,965
Income Tax Expense	**6,866**	7,451
Net Income	$ **11,790**	$ 12,514

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS
(UNAUDITED)

ASSETS	March 31, 2009	December 31, 2008
	(in thousands)	
Current Assets		
Cash and cash equivalents	$ 14,651	$ 11,768
Receivables (net of allowance for doubtful accounts of $466 at March 31, 2009 and $432 at December 31, 2008)	43,058	52,336
Inventory	35,455	33,045
Other	16,456	26,051
Total current assets	109,620	123,200
Investments and Other Assets		
Intangible assets	9,341	10,503
Other	3,960	4,392
Total investments and other assets	13,301	14,895
Property, Plant, and Equipment		
Cost	1,541,128	1,536,785
Less accumulated depreciation and amortization	628,183	625,727
Net property, plant, and equipment	912,945	911,058
Regulatory Assets and Deferred Debits		
Deferred debt expense	5,211	5,308
Regulatory Assets	49,688	47,742
Total regulatory assets and deferred debits	54,899	53,050
Total Assets	$ 1,090,765	$ 1,102,203

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
BALANCE SHEETS
(UNAUDITED)

LIABILITIES AND COMMON STOCKHOLDER'S EQUITY

	March 31, 2009	December 31, 2008
	(in thousands)	
Current Liabilities		
Accounts payable	$ 45,387	$ 51,936
Notes payable	-	3,241
Taxes accrued	10,772	11,212
Interest accrued	1,306	3,828
Current maturities of long-term debt	22,374	22,461
Other	12,984	14,274
Total current liabilities	92,823	106,952
Long-term Debt	315,832	316,168
Deferred Credits and Other Liabilities		
Deferred income taxes	174,221	171,851
Investment tax credit	4,281	4,519
Accrued pension and other postretirement benefit costs	28,897	39,180
Regulatory liabilities	44,105	40,482
Asset retirement obligations	6,471	6,390
Other	18,320	22,636
Total deferred credits and other liabilities	276,295	285,058
Commitments and Contingencies (See Note 9)		
Common Stockholder's Equity		
Common stock – $15.00 par value; 1,000,000 shares authorized and 585,333 shares outstanding at March 31, 2009 and December 31, 2008	8,780	8,780
Paid-in capital	167,494	167,494
Retained earnings	229,541	217,751
Total common stockholder's equity	405,815	394,025
Total Liabilities and Common Stockholder's Equity	$ 1,090,765	$ 1,102,203

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF CHANGES IN COMMON STOCKHOLDER'S EQUITY AND COMPREHENSIVE INCOME
(UNAUDITED)
(in thousands)

				Accumulated Other Comprehensive Income (Loss)	
	Common Stock	Paid-in Capital	Retained Earnings	Net Gains (Losses) on Cash Flow Hedges	Total Common Stockholder's Equity
Balance at December 31, 2007	$ 8,780	$ 167,494	$ 210,270	$ (998)	$ 385,546
Net income			12,514		12,514
Other comprehensive income					
Cash flow hedges, net of tax expense of $628				998	998
Total comprehensive income					13,512
Balance at March 31, 2008	$ 8,780	$ 167,494	$ 222,784	$ -	$ 399,058
Balance at December 31, 2008	$ 8,780	$ 167,494	$ 217,751	$ -	$ 394,025
Net income and total comprehensive income			11,790		11,790
Balance at March 31, 2009	$ 8,780	$ 167,494	$ 229,541	$ -	$ 405,815

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC.
STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Three Months Ended March 31, 2009	2008
	(in thousands)	
Cash Flows from Operating Activities		
Net income	$ 11,790	$ 12,514
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,947	8,192
Deferred income taxes	4,433	(2,735)
Regulatory asset/liability amortization	435	452
Contribution to company sponsored pension plan	(13,554)	-
Accrued pension and other postretirement benefit costs	391	584
(Increase) decrease in:		
Net realized and unrealized mark-to-market and hedging transactions	2,072	1,158
Receivables	17,554	3,900
Inventory	(2,410)	6,822
Other current assets	7,518	4,451
Increase (decrease) in:		
Accounts payable	(3,302)	(554)
Taxes accrued	(441)	6,818
Other current liabilities	(4,070)	(835)
Regulatory asset/liability deferrals	(6,304)	7,859
Other assets	3,165	1,169
Other liabilities	(4,275)	(2,133)
Net cash provided by operating activities	23,949	47,662
Cash Flows from Investing Activities		
Capital expenditures	(12,404)	(14,025)
Notes from affiliate, net	(4,985)	-
Other	42	-
Net cash used in investing activities	(17,347)	(14,025)
Cash Flows from Financing Activities		
Redemption of long-term debt	(437)	(440)
Other	(3,282)	(27,044)
Net cash used in financing activities	(3,719)	(27,484)
Net increase in cash and cash equivalents	2,883	6,153
Cash and cash equivalents at beginning of period	11,768	9,302
Cash and cash equivalents at end of period	$ 14,651	$ 15,455

See Notes to Unaudited Financial Statements

DUKE ENERGY KENTUCKY, INC
Notes to Unaudited Financial Statements – (Continued)

1. Basis of Presentation

Nature of Operations. Duke Energy Kentucky, Inc. (Duke Energy Kentucky), a Kentucky corporation organized in 1901, is a combination electric and gas public utility company that provides service in northern Kentucky. Duke Energy Kentucky's principal lines of business include generation, transmission and distribution of electricity as well as the sale of and/or transportation of natural gas. Duke Energy Kentucky's common stock is wholly owned by Duke Energy Ohio, Inc. (Duke Energy Ohio), an Ohio corporation organized in 1837, which is wholly owned by Cinergy Corp. (Cinergy), a Delaware corporation organized in 1993. Cinergy is a wholly owned subsidiary of Duke Energy Corporation (Duke Energy)

These statements reflect Duke Energy Kentucky's proportionate share of the East Bend generating station which is jointly owned with Dayton Power & Light.

These Unaudited Financial Statements reflect all normal recurring adjustments that are, in the opinion of management, necessary to fairly present Duke Energy Kentucky's financial position and results of operations. Amounts reported in the interim Unaudited Statements of Operations are not necessarily indicative of amounts expected for the respective annual periods due to the effects of seasonal temperature variations on energy consumption, regulatory rulings, the timing of maintenance on electric generating units, changes in mark-to-market valuations, changing commodity prices, and other factors.

Use of Estimates. To conform to generally accepted accounting principles (GAAP) in the United States (U.S.), management makes estimates and assumptions that affect the amounts reported in the Unaudited Financial Statements and Notes. Although these estimates are based on management's best available knowledge at the time, actual results could differ.

Unbilled Revenue. Revenues on sales of electricity and gas are recognized when either the service is provided or the product is delivered. Unbilled retail revenues are estimated by applying an average revenue per kilowatt-hour or per thousand cubic feet (Mcf) for all customer classes to the number of estimated kilowatt-hours or Mcfs delivered but not billed. Unbilled wholesale energy revenues are calculated by applying the contractual rate per megawatt hour (MWh) to the number of estimated MWh delivered, but not yet billed. Unbilled wholesale demand revenues are calculated by applying the contractual rate per megawatt (MW) to the MW volume not yet billed. The amount of unbilled revenues can vary significantly from period to period as a result of factors including seasonality, weather, customer usage patterns and customer mix. Unbilled revenues, which are primarily recorded as Receivables on the Balance Sheets, primarily relate to wholesale sales and were approximately $3 million and $1 million, at March 31, 2009 and December 31, 2008, respectively. Additionally, Duke Energy Kentucky sells, on a revolving basis, nearly all of its retail accounts receivable and related collections to Cinergy Receivables Company, LLC (Cinergy Receivables), a bankruptcy remote, special purpose entity that is a wholly-owned limited liability company of Cinergy. The securitization transaction was structured to meet the criteria for sale treatment under Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities-a replacement of FASB Statement No. 125" (SFAS No. 140), and, accordingly, the transfers of receivables are accounted for as sales. Receivables for unbilled revenues of approximately $15 million and $26 million at March 31, 2009 and December 31, 2008, respectively, related to retail accounts receivable at Duke Energy Kentucky were included in the sales of accounts receivable to Cinergy Receivables.

2. Inventory

Inventory consists primarily of coal held for electric generation; materials and supplies; and natural gas held in storage for transmission and sales commitments. Inventory is recorded primarily using the average cost method.

	March 31, 2009	December 31, 2008
	(in thousands)	
Coal held for electric generation	$ 20,789	$ 18,455
Materials and supplies	13,650	13,360
Natural gas	1,017	1,240
Total Inventory	$ 35,456	$ 33,055

Effective November 1, 2008, Duke Energy Kentucky executed agreements with a third party to transfer title of natural gas inventory purchased by Duke Energy Kentucky to the third party. Under the agreements, the gas inventory will be stored and managed for Duke Energy Kentucky and will be delivered on demand. The gas storage agreements will expire on October 31, 2009, unless extended by the third party for an additional 12 months. As a result of the agreements, the combined natural gas inventory of approximately $2 million and $10 million being held by a third party as of March 31, 2009 and December 31, 2008, respectively, has been classified as Other within Current Assets on the Consolidated Balance Sheets.

3. Debt and Credit Facilities

Money Pool. Duke Energy Kentucky receives support for its short-term borrowing needs through its participation with Duke Energy and other Duke Energy subsidiaries in a money pool arrangement. Under this arrangement, those companies with short-term funds may provide short-term loans to affiliates participating under this arrangement. The money pool is structured such that Duke Energy Kentucky separately manages its cash needs and working capital requirements. Accordingly, there is no net settlement of receivables and payables of the participating subsidiaries, as each entity independently participates in the money pool. As of March 31, 2009, Duke Energy Kentucky had a receivable balance of approximately $5 million, which is classified within Receivables in the accompanying Balance Sheets. As of December 31, 2008, Duke Energy Kentucky had amounts outstanding of approximately $3 million, which is classified within Notes Payable in the accompanying Balance Sheets. The $5 million increase in the money pool activity during the three months ended March 31, 2009 is reflected in Notes due from affiliate, net within Net cash used in investing activities on the Statements of Cash Flows. In addition, the $3 million decrease in the money pool activity during the three months ended March 31, 2009 is reflected in Notes payable to affiliate, net within Net cash provided by (used in) financing activities on the Statements of Cash Flows.

Available Credit Facilities and Capacity Utilized Under Available Credit Facilities. The total credit facility capacity under Duke Energy's master credit facility is approximately $3.14 billion. Duke Energy has the unilateral ability under the master credit facility to increase or decrease the borrowing sub limits of each borrower, subject to maximum cap limitation, at any time. At March 31, 2009, Duke Energy Kentucky had a borrowing sub limit under Duke Energy's master credit facility of $100 million. The amount available to Duke Energy Kentucky under its sub limit to Duke Energy's master credit facility has been reduced by drawdowns of cash, borrowings through the money pool arrangement, and the use of the master credit facility to backstop issuances of letters of credit and pollution control bonds, as discussed below.

In September 2008, Duke Energy and its wholly-owned subsidiaries, including Duke Energy Kentucky, borrowed a total of approximately $1 billion under Duke Energy's master credit facility, of which Duke Energy Kentucky's portion is approximately $74 million. Duke Energy Kentucky's amount remained outstanding as of March 31, 2009. The loans, which are revolving credit loans, bear interest at one-month London Interbank Offered Rate (LIBOR) plus an applicable spread ranging from 19 to 24 basis points and are due in September 2009; however, Duke Energy Kentucky has the ability under the master credit facility to renew the loan up through the date the master credit facility matures, which is in June 2012. As Duke Energy Kentucky has the intent and ability to refinance this obligation on a long-term basis, either through renewal of the terms of the loan through the master credit facility, which has non-cancelable terms in excess of one-year, or through issuance of long-term debt to replace the amounts drawn under the master credit facility, Duke Energy Kentucky's borrowing is reflected as Long-Term Debt on the Balance Sheets at March 31, 2009. This borrowing reduces Duke Energy Kentucky's available credit capacity under Duke Energy's Master Credit Facility, as discussed above.

At both March 31, 2009 and December 31, 2008, approximately $50 million of certain pollution control bonds, which are short-term obligations by nature, are classified as Long-Term Debt on the Consolidated Balance Sheets due to Duke Energy Kentucky's intent and ability to utilize such borrowings as long-term financing. Duke Energy Kentucky's credit facility with non-cancelable terms in excess of one year as of the balance sheet date gives Duke Energy Kentucky the ability to refinance these short-term obligations on a long-term basis. This specific purpose credit facility backstopped the $50 million of pollution control bonds outstanding at March 31, 2009.

Restrictive Debt Covenants. Duke Energy's debt and credit agreement contains various financial and other covenants. Duke Energy Kentucky's debt agreements also contain various financial and other covenants. Failure to meet these covenants beyond applicable grace periods could result in accelerated due dates and/or termination of the agreements. As of March 31, 2009, Duke Energy and Duke Energy Kentucky were in compliance with all covenants that would impact Duke Energy Kentucky's ability to borrow funds under the debt and credit facilities. In addition, some credit agreements may allow for acceleration of payments or termination of the agreements due to nonpayment, or the acceleration of other significant indebtedness of the borrower or some of its subsidiaries. None of the debt or credit agreements contain material adverse change clauses.

4. Employee Benefit Obligations

Duke Energy Kentucky participates in pension and other postretirement benefit plans sponsored by Cinergy. Duke Energy Kentucky's net periodic benefit costs as allocated by Cinergy were as follows:

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
	(in thousands)	
Qualified Pension Benefits	$ 255	$ 266
Other Postretirement Benefits	$ 131	$ 318

Duke Energy's policy is to fund amounts for its U.S. qualified pension plans on an actuarial basis to provide assets sufficient to meet benefit payments to be paid to plan participants. In February 2009, Duke Energy Kentucky made a cash contribution of approximately $14 million, which represented its proportionate share of an approximate $500 million total contribution to Cinergy's and Duke Energy's qualified pension plans. Duke Energy did not make contributions to the legacy Cinergy qualified or non-qualified pension plans during the three months ended March 31, 2008. Duke Energy does not anticipate making additional contributions to the legacy Cinergy qualified or non-qualified pension plans during the remainder of 2009. Cinergy also sponsors employee savings plans that cover substantially all employees. Duke Energy Kentucky expensed pre-tax employer matching contributions of approximately $279 thousand and $213 thousand for each of the three months ended March 31, 2009 and 2008, respectively.

5. Intangibles

The carrying amount of emission allowances in intangible assets as of March 31, 2009 and December 31, 2008 is $9 million and $11 million, respectively.

During the three months ended March 31, 2009 and 2008, the carrying value of emission allowances sold or consumed was $1 million in each period.

6. Related Party Transactions

Duke Energy Kentucky engages in related party transactions which are generally performed at cost and in accordance with the applicable state and federal commission regulations. Balances due to or due from related parties included in the Balance Sheets as of March 31, 2009 and December 31, 2008 are as follows:

	March 31, 2009	December 31, 2008
	(in thousands)	
Accounts Receivable	$ 131	$10,765
Accounts Payable	$19,025	$13,478

Duke Energy Kentucky is charged its proportionate share of corporate governance and other costs by a consolidated affiliate of Duke Energy. Duke Energy Kentucky is also charged its proportionate share of other corporate governance costs from a consolidated affiliate of Cinergy. Corporate governance and other shared services costs are primarily related to human resources, legal and accounting fees, as well as other third party costs. The expenses associated with certain allocated corporate governance and other shared service costs for Duke Energy Kentucky, which are recorded in Operation, Maintenance and Other within Operating Expenses on the Statements of Operations were $21 and $12 million for the three months ended March 31, 2009 and 2008, respectively.

See Note 4 for detail on expense amounts allocated from Cinergy to Duke Energy Kentucky related to Duke Energy Kentucky's participation in Cinergy's qualified and non-qualified defined benefit pension plans and post-retirement health care and insurance benefits. Additionally, Duke Energy Kentucky has been allocated accrued pension and other post-retirement and post-employment benefit obligations from Cinergy of approximately $26 million at March 31, 2009 and approximately $39 million at December 31, 2008. The above amounts have been classified in the Balance Sheet as follows:

		March 31, 2009		December 31, 2008
		(in thousands)		
Other current liabilities	$	**108**	$	108
Accrued pension and other postretirement benefit costs	$	**25,815**	$	39,195

As discussed in Note 1, certain trade receivables have been sold by Duke Energy Kentucky to Cinergy Receivables. The proceeds obtained from the sales of receivables are largely cash, but do include a subordinated note from Cinergy Receivables for a portion of the purchase price. This subordinated note is classified as Receivables in the Balance Sheets and was approximately $25 million and $29 million as of March 31, 2009 and December 31, 2008, respectively. The interest income associated with the subordinated note, which is recorded in Other Income and Expenses, net on the Statements of Operations, was approximately $1 million for each of the three months ended March 31, 2009 and 2008.

As discussed further in Note 3, Duke Energy Kentucky participates in a money pool arrangement with Duke Energy and other Duke Energy subsidiaries. As of March 31, 2009, Duke Energy Kentucky was in a receivable position of approximately $5 million. As of December 31, 2008, Duke Energy Kentucky was in a payable position of approximately $3 million.

7. Risk Management Instruments

Duke Energy Kentucky has limited exposure to market price changes of fuel and emission allowance costs incurred for its retail customers due to the use of cost tracking and recovery mechanisms in the state of Kentucky. Duke Energy Kentucky does have exposure to the impact of market fluctuations in the prices of electricity, fuel and emission allowances associated with its generation output not utilized to serve native load or committed load. Exposure to interest rate risk exists as a result of the issuance of variable and fixed rate debt. Duke Energy Kentucky employs established policies and procedures to manage its risks associated with these market fluctuations using various commodity and financial derivative instruments, including swaps, futures, forwards and options.

Interest Rate (Fair Value or Cash Flow) Hedges. Changes in interest rates expose Duke Energy Kentucky to risk as a result of its issuance of variable and fixed rate debt. Duke Energy Kentucky manages its interest rate exposure by limiting its variable-rate exposures to a percentage of total capitalization and by monitoring the effects of market changes in interest rates. Duke Energy Kentucky also enters into interest rate swaps to manage and mitigate interest rate risk exposure.

Duke Energy Kentucky's recognized interest rate derivative ineffectiveness was not material to its results of operations, cash flows or financial position in 2009 and 2008.

See Note 10 for additional information related to the fair value of Duke Energy Kentucky's derivative instruments.

8. Regulatory Matters

Franchised Electric and Gas

Rate Related Information. The Kentucky Public Service Commission (KPSC) approves rates for retail electric and gas services within the Commonwealth of Kentucky.

Duke Energy Kentucky Gas Rate Cases. In 2002, the KPSC approved Duke Energy Kentucky's gas base rate case which included, among other things, recovery of costs associated with an accelerated gas main replacement program. The approval authorized a tracking mechanism to recover certain costs including depreciation and a rate of return on the program's capital expenditures. The Kentucky Attorney General appealed to the Franklin Circuit Court the KPSC's approval of the tracking mechanism as well as the KPSC's subsequent approval of annual rate adjustments under this tracking mechanism. In 2005, both Duke Energy Kentucky and the KPSC requested that the court dismiss these cases.

In February 2005, Duke Energy Kentucky filed a gas base rate case with the KPSC requesting approval to continue the tracking mechanism and for a $14 million annual increase in base rates. A portion of the increase is attributable to recovery of the current cost of the accelerated gas main replacement program in base rates. In June 2005, the Kentucky General Assembly enacted Kentucky Revised Statue 278.509 (KRS 278.509), which specifically authorizes the KPSC to approve tracker recovery for utilities' gas main replacement programs. In December 2005, the KPSC approved an annual rate increase of $8 million and re-approved the tracking mechanism through 2011. In February 2006, the Kentucky Attorney General appealed the KPSC's order to the Franklin Circuit Court, claiming that the order improperly allows Duke Energy Kentucky to increase its rates for gas main replacement costs in between general rate cases, and also claiming that the order improperly allows Duke Energy Kentucky to earn a return on investment for the costs recovered under the tracking mechanism which permits Duke Energy Kentucky to recover its gas main replacement costs.

In August 2007, the Franklin Circuit Court consolidated all the pending appeals and ruled that the KPSC lacks legal authority to approve the gas main replacement tracking mechanism, which were approved prior to enactment of KRS 278.509. To date, Duke Energy Kentucky has collected approximately $9 million in annual rate adjustments under the tracking mechanism. Per the KPSC order, Duke Energy Kentucky collected these revenues subject to refund pending the final outcome of this litigation. Duke Energy Kentucky and the KPSC have requested that the Kentucky Court of Appeals grant a rehearing of its decision. On February 5, 2009, the Kentucky Court of Appeals denied the rehearing requests of both Duke Energy Kentucky and the KPSC. Duke Energy Kentucky filed a motion for discretionary review to the Kentucky Supreme Court on March 9, 2009. At this time, Duke Energy Kentucky cannot predict whether the Kentucky Supreme Court will accept the case for review.

Duke Energy Kentucky Electric Rate Case. In May 2006, Duke Energy Kentucky filed an application for an increase in its base electric rates of approximately $67 million in revenue, or approximately 28 percent, to be effective in January 2007 pursuant to the KPSC's 2003 Order approving the transfer of 1,100 MW of generating assets from Duke Energy Ohio to Duke Energy Kentucky. In the fourth quarter of 2006, the KPSC approved the settlement agreement resolving all the issues raised in the proceeding. Among other things, the settlement agreement provided for a $49 million increase in Duke Energy Kentucky's base electric rates and reinstitution of the fuel cost recovery mechanism, which had been frozen since 2001. The settlement agreement also provided for Duke Energy Kentucky to obtain KPSC approval for a back-up power supply plan. In January 2007, Duke Energy Kentucky filed a back-up power supply plan with the KPSC which was approved in March 2007. The back-up power supply plan included provisions for purchasing fixed-price products for backup power associated with planned outages using fixed price products, and from the Day-Ahead and Real-Time energy markets available from the Midwest Independent Transmission System Operator, Inc. (Midwest ISO) for forced outages.

Energy Efficiency. On November 15, 2007, Duke Energy Kentucky filed its annual application to continue existing energy efficiency programs, consisting of nine residential and two commercial and industrial programs, and to true-up its gas and electric tracking mechanism for recovery of lost revenues, program costs and shared savings. On February 11, 2008, Duke Energy Kentucky filed a motion to amend its energy efficiency programs and applied to reinstitute a low income Home Energy Assistance Program. The KPSC bifurcated the proposed Home Energy Assistance Program from the other energy efficiency programs. On May 14, 2008, the KPSC approved the energy efficiency programs. On September 25, 2008, the KPSC approved Duke Energy Kentucky's Home Energy Assistance program, making it available for customers at or below 150% of the federal poverty level. On December 1, 2008, Duke Energy Kentucky filed an application for a save-a-watt energy efficiency plan. The application seeks a new energy efficiency recovery mechanism similar to what was proposed in Ohio. Intervenor testimony was filed on May 11, 2009. An evidentiary hearing with the KPSC is expected to occur in the third quarter of 2009.

Application for the Establishment of a Regulatory Asset. On November 14, 2008, Duke Energy Kentucky petitioned the KPSC for permission to create a regulatory asset to defer, for future recovery, approximately $5 million for its expenses incurred to repair damage and restore service to its customers following extensive storm-related damage caused by Hurricane Ike on September 14, 2008. The KPSC approved the requested accounting order on January 7, 2009.

Midwest Independent Transmission System Operator, Inc. (Midwest ISO) Resource Adequacy Filing. On December 28, 2007, the Midwest ISO filed its Electric Tariff Filing Regarding Resource Adequacy in compliance with the Federal Energy Regulatory Commission's (FERC) request of Midwest ISO to file Phase II of its long-term Resource Adequacy plan by December 2007. The proposal includes establishment of a resource adequacy requirement in the form of planning reserve margin. On March 26, 2008, the FERC ruled on the Midwest ISO's Resource Adequacy filing and ordered that the new Module E tariff be effective March 27, 2008. This action established a Midwest ISO-wide resource adequacy requirement for the first Planning Year, which begins June 2009. In the Order, the FERC, among other things, clarified that States have the authority to set their own Planning Reserve Margins, as long as they are not inconsistent with any reliability standard approved by the FERC.

Midwest ISO's Establishment of an Ancillary Services Market (ASM). On February 25, 2008, the FERC conditionally accepted the Midwest ISO proposal to implement a day-ahead and real-time ASM, including a scarcity pricing proposal. By approving the ASM proposal, the FERC essentially approved the transfer and consolidation of balancing authority for the entire Midwest ISO area. This will allow the Midwest ISO to determine operating reserve requirements and procure operating reserves from all qualified resources from an organized market, in place of the current system of local management and procurement of reserves by the 24 balancing authorities in the Midwest ISO area. The Midwest ISO launched the ASM on January 6, 2009.

9. Commitments and Contingencies

Environmental

Duke Energy Kentucky is subject to federal, state and local regulations regarding air and water quality, hazardous and solid waste disposal and other environmental matters. These regulations can be changed from time to time, imposing new obligations on Duke Energy Kentucky.

Remediation activities. Duke Energy Kentucky and its affiliates are responsible for environmental remediation at various contaminated sites. These include some properties that are part of ongoing Duke Energy Kentucky operations, sites formerly owned or used by Duke Energy Kentucky entities, and sites owned by third parties. Remediation typically involves management of contaminated soils and may involve groundwater remediation. Managed in conjunction with relevant federal, state and local agencies, activities vary with site conditions and locations, remedial requirements, complexity and sharing of responsibility. If remediation activities involve statutory joint and several liability provisions, strict liability, or cost recovery or contribution actions, Duke Energy Kentucky could potentially be held responsible for contamination caused by other parties. In some instances, Duke Energy Kentucky may share liability associated with contamination with other potentially responsible parties, and may also benefit from insurance policies or contractual indemnities that cover some or all cleanup costs. All of these sites generally are managed in the normal course of business or affiliate operations. Management, in the normal course of business, continually assesses the nature and extent of known or potential environmental-related contingencies and records liabilities when losses become probable and are reasonably estimable. During 2009, it is reasonably possible that Duke Energy Kentucky will incur costs associated with remediation activities at certain of its sites.

Clean Water Act 316(b). The U.S. Environmental Protection Agency (EPA) finalized its cooling water intake structures rule in July 2004. The rule established aquatic protection requirements for existing facilities that withdraw 50 million gallons or more of water per day from rivers, streams, lakes, reservoirs, estuaries, oceans, or other U.S. waters for cooling purposes. Coal-fired generating facilities in which Duke Energy Kentucky is either a whole or partial owner are affected sources under that rule. On April 1, 2009, the U.S. Supreme Court ruled in favor of the plaintiff that the EPA may consider costs when determining which technology option each site should implement. Depending on how the cost-benefit analysis is incorporated into the revised EPA rule, the analysis could narrow the range of technology options required for the affected facilities. Because of the wide range of potential outcomes, Duke Energy Kentucky is unable to estimate its costs to comply at this time.

Clean Air Interstate Rule (CAIR). The EPA finalized its CAIR in May 2005. The CAIR limits total annual and summertime NO_x emissions and annual SO_2 emissions from electric generating facilities across the Eastern U.S. through a two-phased cap-and-trade program. Phase 1 begins in 2009 for NO_x and in 2010 for SO_2. Phase 2 begins in 2015 for both NO_x and SO_2. On March 25, 2008, the U.S. Court of Appeals for the District of Columbia (D.C. Circuit) heard oral argument in a case involving multiple challenges to the CAIR. On July 11, 2008, the D.C. Circuit issued its decision in *North Carolina v. EPA* No. 05-1244 vacating the CAIR. The EPA filed a petition for rehearing on September 24, 2008 with the D.C. Circuit asking the court to reconsider various parts of its ruling vacating CAIR. In December 2008, the D.C. Circuit issued a decision remanding the CAIR to the EPA without vacatur. EPA must now conduct a new rulemaking to modify the CAIR in accordance with the court's July 11, 2008 opinion. This decision means that the CAIR as initially finalized in 2005 remains in effect until the new EPA rule takes effect. The court did not impose a deadline or schedule on the EPA. It is uncertain how long the current CAIR will remain in effect or how the new rulemaking will alter the CAIR.

Duke Energy Kentucky is currently unable to estimate the costs to comply with any new rule the EPA will issue in the future as a result of the D.C. District Court's December 2008 decision discussed above.

Coal Combustion Product (CCP) Management. Duke Energy Kentucky currently estimates that it will spend approximately $2 million over the period 2009-2013 to install synthetic caps and liners at existing and new CCP landfills and to convert CCP handling systems from wet to dry systems.

Comprehensive Environmental Response, Compensation, and Liability Act Matter. In August 2008, Duke Energy Kentucky received a notice from the EPA that it has been identified as a potentially responsible party under the Comprehensive Environmental Response, Compensation, and Liability Act at the LWD, Inc., Superfund Site in Calvert City, Kentucky. At this time, Duke Energy Kentucky does not have any further information regarding the scope of potential liability associated with this matter.

Extended Environmental Activities and Accruals. Included in Other Deferred Credits and Other Liabilities on the Balance Sheets were total accruals related to extended environmental-related activities of approximately $2 million as of March 31, 2009 and December 31, 2008. These accruals represent Duke Energy Kentucky's provisions for costs associated with remediation activities at some of its current and former sites, as well as other relevant environmental contingent liabilities. Management, in the normal course of business, continually assesses the nature and extent of known or potential environmental-related contingencies and records liabilities when losses become probable and are reasonably estimable.

Litigation

Section 126 Petitions. In March 2004, the state of North Carolina filed a petition under Section 126 of the CAA in which it alleges that sources in 13 upwind states, including Kentucky, significantly contribute to North Carolina's non-attainment with certain ambient air quality standards. In August 2005, the EPA issued a proposed response to the petition. The EPA proposed to deny the ozone portion of the petition based upon a lack of contribution to air quality by the named states. The EPA also proposed to deny the particulate matter portion of the petition based upon the CAIR Federal Implementation Plan (FIP), that would address the air quality concerns from neighboring states. On April 28, 2006, the EPA denied North Carolina's petition based upon the final CAIR FIP described above. North Carolina has filed a legal challenge to the EPA's denial. Briefing in that case is under way. On March 5, 2009 the D.C. Circuit remanded the case to the EPA for reconsideration. The EPA has conceded that the D.C. Circuit's July 18, 2008 decision in the CAIR litigation, *North Carolina v. EPA* No. 05-1244, discussed above, and a subsequent order issued by the D.C. Circuit on December 23, 2008, have eliminated the legal basis for the EPA's denial of North Carolina's Section 126 petition. At this time, Duke Energy Kentucky cannot predict the outcome of this proceeding.

Carbon Dioxide (CO_2) Litigation. In July 2004, the states of Connecticut, New York, California, Iowa, New Jersey, Rhode Island, Vermont, Wisconsin and the City of New York brought a lawsuit in the U.S. District Court for the Southern District of New York against Cinergy, American Electric Power Company, Inc., American Electric Power Service Corporation, The Southern Company, Tennessee Valley Authority, and Xcel Energy Inc. A similar lawsuit was filed in the U.S. District Court for the Southern District of New York against the same companies by Open Space Institute, Inc., Open Space Conservancy, Inc., and The Audubon Society of New Hampshire. These lawsuits allege that the defendants' emissions of CO_2 from the combustion of fossil fuels at electric generating facilities contribute to global warming and amount to a public nuisance. The complaints also allege that the defendants could generate the same amount of electricity while emitting significantly less CO_2. The plaintiffs are seeking an injunction requiring each defendant to cap its CO_2 emissions and then reduce them by a specified percentage each year for at least a decade. In September 2005, the District Court granted the defendants' motion to dismiss the lawsuit. The plaintiffs have appealed this ruling to the Second Circuit Court of Appeals. Oral argument was held before the Second Circuit Court of Appeals on June 7, 2006. It is not possible to predict with certainty whether Duke Energy Kentucky will incur any liability or to estimate the damages, if any, that Duke Energy Kentucky might incur in connection with this matter.

Hurricane Katrina Lawsuit. In April 2006, Cinergy was named in the third amended complaint of a purported class action lawsuit filed in the U.S. District Court for the Southern District of Mississippi. Plaintiffs claim that Cinergy, along with numerous other utilities, oil companies, coal companies and chemical companies, are liable for damages relating to losses suffered by victims of Hurricane Katrina. Plaintiffs claim that defendants' greenhouse gas emissions contributed to the frequency and intensity of storms such as Hurricane Katrina. On August 30, 2007, the court dismissed the case. The plaintiffs have filed their appeal to the Fifth Circuit Court of Appeals, and oral arguments were heard on August 6, 2008. Due to the late recusal of one of the judges on the Fifth Circuit panel, the court held a new oral argument on November 3, 2008. It is not possible to predict with certainty whether Duke Energy Kentucky will incur any liability or to estimate the damages, if any, that Duke Energy Kentucky might incur in connection with this matter.

Other Litigation and Legal Proceedings. Duke Energy Kentucky is involved in other legal, tax and regulatory proceedings arising in the ordinary course of business, some of which involve substantial amounts. Duke Energy Kentucky believes that the final disposition of these proceedings will not have a material adverse effect on its results of operations, cash flows or financial position.

Duke Energy Kentucky has exposure to certain legal matters that are described herein. As of March 31, 2009 and December 31, 2008, Duke Energy Kentucky has recorded insignificant reserves for these proceedings and exposures. Duke Energy Kentucky expenses legal costs related to the defense of loss contingencies as incurred.

10. Fair Value of Financial Assets and Liabilities

On January 1, 2008, Duke Energy Kentucky adopted SFAS No. 157. Through December 31, 2008, Duke Energy Kentucky's adoption of SFAS No. 157 was limited to financial instruments and to non-financial derivatives as, in February 2008, the FASB issued FSP No. 157-2, *"Effective Date of FASB Statement No. 157,"* which delayed the effective date of SFAS No. 157 until January 1, 2009 for non-financial assets and liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. There was no cumulative effect adjustment to retained earnings for Duke Energy Kentucky as a result of the adoption of SFAS No. 157.

SFAS No. 157 defines fair value, establishes a framework for measuring fair value in GAAP in the U.S. and expands disclosure requirements about fair value measurements. Under SFAS No. 157, fair value is considered to be the exchange price in an orderly transaction between market participants to sell an asset or transfer a liability at the measurement date. The fair value definition under SFAS No. 157 focuses on an exit price, which is the price that would be received by Duke Energy Kentucky to sell an asset or paid to transfer a liability versus an entry price, which would be the price paid to acquire an asset or received to assume a liability. Although SFAS No. 157 does not require additional fair value measurements, it applies to other accounting pronouncements that require or permit fair value measurements.

Duke Energy Kentucky determines fair value of financial assets and liabilities based on the following fair value hierarchy, as prescribed by SFAS No. 157, which prioritizes the inputs to valuation techniques used to measure fair value into three levels:

Level 1 inputs – unadjusted quoted prices in active markets for identical assets or liabilities that Duke Energy Kentucky has the ability to access. An active market for the asset or liability is one in which transactions for the asset or liability occur with sufficient frequency and volume to provide ongoing pricing information. Duke Energy Kentucky does not adjust quoted market prices on Level 1 inputs for any blockage factor.

Level 2 inputs – inputs other than quoted market prices included in Level 1 that are observable, either directly or indirectly, for the asset or liability. Level 2 inputs include, but are not limited to, quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active and inputs other than quoted market prices that are observable for the asset or liability, such as interest rate curves and yield curves observable at commonly quoted intervals, volatilities, credit risk and default rates.

Level 3 inputs – unobservable inputs for the asset or liability.

In February 2007, the FASB issued SFAS No. 159, *"The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of FASB Statement No. 115"* (SFAS No. 159), which permits entities to elect to measure many financial instruments and certain other items at fair value. For Duke Energy Kentucky, SFAS No. 159 was effective as of January 1, 2008 and had no impact on amounts presented for periods prior to the effective date. Duke Energy Kentucky does not currently have any financial assets or financial liabilities for which the provisions of SFAS No. 159 have been elected. However, in the future, Duke Energy Kentucky may elect to measure certain financial instruments at fair value in accordance with this standard.

The following table provides the fair value measurement amounts for assets and liabilities recorded in Unrealized gains on mark-to-market and hedging transactions and Unrealized losses on mark-to-market and hedging transactions on Duke Energy Kentucky's Balance Sheets at fair value at March 31, 2009:

Description	Total Fair Value Amounts at March 31, 2009	Level 1	Level 2	Level 3
		(in thousands)		
Derivative Assets	$ —	$ —	$ —	$ —
Derivative Liabilities	(8,057)	(1,479)	(6,550)	(27)
Net Liabilities	$(8,057)	$(1,479)	$(6,550)	$(27)

Description	Total Fair Value Amounts at December 31, 2008	Level 1	Level 2	Level 3
		(in thousands)		
Derivative Assets	$ 178	$ —	$ —	$178

	Total Fair Value Amounts at March 31, 2009	Level 1	Level 2	Level 3
		(in thousands)		
Derivative Liabilities	(7,977)	—	(7,977)	—
Net (Liabilities) Assets	$(7,799)	$ —	$(7,977)	$178

The following table provides a reconciliation of beginning and ending balances of assets measured at fair value on a recurring basis where the determination of fair value includes significant unobservable inputs (Level 3):

Rollforward of Level 3 Measurements

	Derivatives (net)
	(in thousands)
Balance at January 1, 2009	$178
Total gains included on balance sheet	(64)
Net purchases, sales, issuances and settlements	(141)
Balance at March 31, 2009	$(27)
Balance at January 1, 2008	$ —
Total gains included on balance sheet	318
Net purchases, sales, issuances and settlements	—
Balance at March 31, 2008	$318

Fair Value Disclosures Required Under FSP No. FAS 107-1 and Accounting Principles Board (APB) 28-1, "*Interim Disclosures About Fair Value of Financial Instruments.*" The fair value of financial instruments, excluding financial assets included in the scope of SFAS No. 157 disclosed in the tables above, is summarized in the following table. Judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, the estimates determined as of March 31, 2009 and December 31, 2008 are not necessarily indicative of the amounts Duke Energy Kentucky could have realized in current markets.

	As of March 31, 2009		As of December 31, 2008	
	Book Value	Approximate Fair Value	Book Value	Approximate Fair Value
		(in thousands)		
Long-term debt, including current maturities	$338,206	$326,335	$338,629	$327,228

The fair value of cash and cash equivalents, accounts receivable, restricted funds held in trust, accounts payable and notes payable are not materially different from their carrying amounts because of the short-term nature of these instruments and/or because the stated rates approximate market rates.

11. New Accounting Standards

The following new accounting standards were adopted by Duke Energy Kentucky subsequent to March 31, 2008 and the impact of such adoption, if applicable, has been presented in the accompanying Financial Statements:

SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – an amendment to FASB Statement No. 133" (SFAS No. 161). In March 2008, the FASB issued SFAS No. 161, which amends and expands the disclosure requirements for derivative instruments and hedging activities prescribed by SFAS No. 133, "*Accounting for Derivative Instruments and Hedging Activities.*" SFAS No. 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. Duke Energy Kentucky adopted SFAS No. 161 as of January 1, 2009. The adoption of SFAS No. 161 did not have any impact on Duke Energy Kentucky's results of operations, cash flows or financial position. See Note 10 for the disclosures required under SFAS No. 161.

12. Income Taxes and Other Taxes

The taxable income of Duke Energy Kentucky is reflected in Duke Energy's U.S. federal and state income tax returns. Duke Energy Kentucky has a tax sharing agreement with Duke Energy, where the separate return method is used to allocate tax expenses and benefits to the subsidiaries whose investments or results of operations provide these tax expenses and benefits.

The accounting for income taxes essentially represents the income taxes that Duke Energy Kentucky would incur if Duke Energy Kentucky were a separate company filing its own tax return as a C-Corporation.

Duke Energy Kentucky has the following tax years open:

Jurisdiction	Tax Years
Federal	2005 and after
State	Closed through 2001, with the exception of any adjustments related to open federal years

The $585 thousand decrease in income tax expense for the comparative three-month periods ended March 31, 2009 and 2008 is due primarily to the $1.3 million decrease in pre-tax income.

13. Sales of Accounts Receivable

Accounts Receivable Securitization. Duke Energy Kentucky sells, on a revolving basis, nearly all of its retail accounts receivable and related collections to Cinergy Receivables. The securitization transaction was structured to meet the criteria for sale treatment under SFAS No. 140 and, accordingly, the transfers of receivables are accounted for as sales.

The proceeds obtained from the sales of receivables are largely cash but do include a subordinated note from Cinergy Receivables for a portion of the purchase price (typically approximates 25 percent of the total proceeds). The note, which amounts to approximately $25 million and $29 million at March 31, 2009 and December 31, 2008, respectively, is subordinate to senior loans that Cinergy Receivables obtain from commercial paper conduits controlled by unrelated financial institutions which is the source of funding for the subordinated note. This subordinated note is a retained interest (right to receive a specified portion of cash flows from the sold assets) under SFAS No. 140 and is classified within Receivables in the accompanying Balance Sheets at March 31, 2009 and March December 31, 2008.

In 2008, the governing purchase and sale agreement was amended to allow Cinergy Receivables to convey its bankrupt receivables to the applicable originator for consideration equal to the fair market value of such receivables as of the disposition date. The amount of bankrupt receivables sold is limited to 1% of aggregate sales of the originator during the most recently completed 12 month period. Cinergy Receivables and Duke Energy Kentucky completed a sale under this amendment in 2008.

Duke Energy Kentucky retains servicing responsibilities for its role as a collection agent on the amounts due on the sold receivables. However, Cinergy Receivables assumes the risk of collection on the purchased receivables without recourse to Duke Energy Kentucky in the event of a loss. While no direct recourse to Duke Energy Kentucky exists, it risks loss in the event collections are not sufficient to allow for full recovery of its retained interests. No servicing asset or liability is recorded since the servicing fee paid to Duke Energy Kentucky approximates a market rate.

The carrying value of the retained interest is determined by allocating the carrying value of the receivables between the assets sold and the interests retained based on relative fair value. The key assumptions used in estimating the fair value for 2009 were an anticipated credit loss ratio of .9%, a discount rate of 2.8% and a receivable turnover rate of 12.2%. Because (a) the receivables generally turnover in less than two months, (b) credit losses are reasonably predictable due to Duke Energy Kentucky's broad customer base and lack of significant concentration, and (c) the purchased beneficial interest is subordinate to all retained interests and thus would absorb losses first, the allocated bases of the subordinated notes are not materially different than their face value. The hypothetical effect on the fair value of the retained interests assuming both a 10% and a 20% unfavorable variation in credit losses or discount rates is not material due to the short turnover of receivables and historically low credit loss history. Interest accrues to Duke Energy Kentucky on the retained interests using the accretable yield method, which generally approximates the stated rate on the notes since the allocated basis and the face value are nearly equivalent. An impairment charge is recorded against the carrying value of both the retained interests and purchased beneficial interest whenever it is determined that an other-than-temporary impairment has occurred.

The following table shows the gross and net receivables sold, retained interests, sales, and cash flows during the three months ended March 31, 2009:

	Three Months Ended March 31, 2009
	(in thousands)
Receivables sold as of March 31,	$68,251
Less: Retained interests	24,853
Net receivables sold as of March 31,	$43,398
Sales	
Receivables sold	$152,160
Loss recognized on sale	1,248
Cash flows	
Cash proceeds from receivables sold	$154,588
Collection fees received	76
Return received on retained interests	804

14. Subsequent Events

For information on subsequent events related to regulatory matters, see Note 8.